COE
Revised February 2018

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

Code of Ethics for Professional Accountants

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

COPYRIGHT

© Copyright 2018 Hong Kong Institute of Certified Public Accountants

This Code of Ethics for Professional Accountants is based on the Code of Ethics for Professional Accountants of the International Ethics Standards Board for Accountants, published by the International Federation of Accountants (IFAC) in July 2016 and is used with permission of IFAC.

Responding to Non-Compliance with Laws and Regulations, ISBN 978-1-60815-289-6 © July 2016 by the International Federation of Accountants.

This Code of Ethics contains IFAC copyright material. Reproduction within Hong Kong in unaltered form (retaining this notice) is permitted for personal and non-commercial use subject to the inclusion of an acknowledgment of the source. Requests and inquiries concerning reproduction and rights for commercial purposes within Hong Kong should be addressed to the Director, Operation and Finance, Hong Kong Institute of Certified Public Accountants, 37/F., Wu Chung House, 213 Queen's Road East, Wanchai, Hong Kong.

All rights in this material outside of Hong Kong are reserved by IFAC. Reproduction of Code of Ethics outside of Hong Kong in unaltered form (retaining this notice) is permitted for personal and non-commercial use only. Further information and requests for authorisation to reproduce for commercial purposes outside Hong Kong should be addressed to the IFAC at www.ifac.org.

CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS

CONTENTS

		Pages
PREFACE		5
PART A: GENERAL APPLICATION OF THE CODE		6
100	Introduction and Fundamental Principles	7-11
110	Integrity	12
120	Objectivity	13
130	Professional Competence and Due Care	14
140	Confidentiality	15-16
150	Professional Behavior	17
PART B: PROFESSIONAL ACCOUNTANTS IN PUBLIC PRACTICE		18
200	Introduction	19-22
210	Professional Appointment	23-25
220	Conflicts of Interest	26-29
225	Responding to Non-Compliance with Laws and Regulations	30-39
230	Second Opinions	40
240	Fees and Other Types of Remuneration	41-42
250	Marketing Professional Services	43
260	Gifts and Hospitality	44
270	Custody of Client Assets	45
280	Objectivity – All Services	46
290	Independence – Audit and Review Engagements	47-86
291	Independence – Other Assurance Engagements	87-108
PART C: PROFESSIONAL ACCOUNTANTS IN BUSINESS		109
300	Introduction	110-112
310	Conflicts of Interest	113-114
320	Preparation and Reporting of Information	115
330	Acting with Sufficient Expertise	116
340	Financial Interests, Compensation and Incentives Linked to Financial Reporting and Decision Making	117-118
350	Inducements	119-120
360	Responding to Non-Compliance with Laws and Regulations	121-127
PART D: ADDITIONAL ETHICAL REQUIREMENTS		128
400	Introduction	129
410	Unlawful Acts or Defaults by Clients of Members	130-148
411	Unlawful Acts or Defaults by or on Behalf of a Member's Employer	149-152
420	Use of Designations and Institute's Logo	153-154
430	Ethics in Tax Practice	155-156
431	Corporate Finance Advice	157-165
440	Changes in a Professional Appointment	166-173
441	Change of Auditors of a Listed Issuer of The Stock Exchange of Hong Kong	174-177
450	Practice Promotion	178-181
460	Clients' Monies	182-183

PART E: SPECIALIZED AREAS OF PRACTICE 184
500 Professional Ethics in Liquidation and Insolvency (Effective on 1 April 2012) 185-204
PART F – GUIDELINES ON ANTI-MONEY LAUNDERING AND COUNTER-TERRORIST FINANCING FOR PROFESSIONAL ACCOUNTANTS (Effective on 1 March 2018) 205
600 Overview and Application..... 206-210
610 AML/CFT Policies, Procedures and Controls 211-214
620 Customer Due Diligence 215-228
630 Ongoing Monitoring..... 229-230
640 Making Suspicious Transaction Reports 231-238
650 Financial Sanctions and Terrorist Financing 239-241
660 Record Keeping 242-243
670 Staff Hiring and Training 244-245
Appendix A – E 246-268

DEFINITIONS 269-274
EFFECTIVE DATE 275-276
APPENDIX 1: Sample Code of Conduct under the Prevention of Bribery Ordinance…….. 277-283
APPENDIX 2: Comparison with the IESBA Code of Ethics for Professional Accountants…….. 284

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 IESBA *Code of Ethics for Professional Accountants* issued by the IFAC International Ethics Standards Board of Accountants (IESBA) 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 IESBA *Code of Ethics for Professional Accountants*.

6. In addition to the IESBA Code, the Hong Kong Institute of Certified Public Accountants *Code of Ethics for Professional Accountants* (the Code) has an additional Part D, which are either local application or represent an amplification of provisions in the IESBA Code, and Part E, which applies to specialized areas of practice. There are relevant sections in Part A and Part B for which there are additional requirements in Part D or additional local requirements. Part D and Part E form an integral part of this Code. Members need to be aware of these additional requirements and comply with them. Additional local guidance is also provided, which is either incorporated by way of footnotes, Appendices or references to the relevant sections in Part D and Part E.

7. 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.

8. Council requires members of the Institute to comply with the Code. Apparent failures by members of the Institute to comply with the Code are liable to be enquired into by the appropriate committee established under the authority of the Institute, and disciplinary action may result. Disciplinary action may include an order that the name of the member be removed from the Institute's membership register.

9. 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

	Pages
Section 100 Introduction and Fundamental Principles	7-11
Section 110 Integrity	12
Section 120 Objectivity	13
Section 130 Professional Competence and Due Care	14
Section 140 Confidentiality	15-16
Section 150 Professional Behavior	17

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 shall observe and comply with this Code. If a professional accountant is prohibited from complying with certain parts of this Code by law or regulation, the professional accountant shall comply with all other parts of this Code.

100.2 This Code contains five parts. Part A establishes the fundamental principles of professional ethics for professional accountants and provides a conceptual framework that professional accountants shall apply to:

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

(b) Evaluate the significance of the threats identified; and

(c) Apply safeguards, when necessary, to eliminate the threats or reduce them to an acceptable level. Safeguards are necessary when the professional accountant determines that the threats are not at a level at which a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances available to the professional accountant at that time, that compliance with the fundamental principles is not compromised.

A professional accountant shall use professional judgment in applying this conceptual framework.

100.3 Parts B, C, D and E describe how the conceptual framework applies in certain situations. They provide examples of safeguards that may be appropriate to address threats to compliance with the fundamental principles. They also describe situations where safeguards are not available to address the threats, and consequently, the circumstance or relationship creating the threats shall 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 Part C relevant to their particular circumstances. Part D sets out additional ethical requirements on specific areas. Part E sets out ethical requirements that apply to specialized areas of practice.

100.4 The use of the word "shall" in this Code imposes a requirement on the professional accountant or firm to comply with the specific provision in which "shall" has been used. Compliance is required unless an exception is permitted by this Code.

Fundamental Principles

100.5 A professional accountant shall comply with the following fundamental principles:

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

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

(c) *Professional Competence and Due Care* – to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional services based on current developments in practice, legislation and techniques and act diligently and in accordance with applicable technical and professional standards.

(d) *Confidentiality* – to respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for the personal advantage of the professional accountant or third parties.

(e) *Professional Behavior* – to comply with relevant laws and regulations and avoid any conduct that discredits the profession.

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

Conceptual Framework Approach

100.6 The circumstances in which professional accountants operate may create specific threats to compliance with the fundamental principles. It is impossible to define every situation that creates threats to compliance with the fundamental principles and specify the appropriate action. In addition, the nature of engagements and work assignments may differ and, consequently, different threats may be created, requiring the application of different safeguards. Therefore, this Code establishes a conceptual framework that requires a professional accountant to identify, evaluate, and address threats to compliance with the fundamental principles. The conceptual framework approach assists professional accountants in complying with the ethical requirements of this Code and meeting their responsibility to act in the public interest. It accommodates many variations in circumstances that create threats to compliance with the fundamental principles and can deter a professional accountant from concluding that a situation is permitted if it is not specifically prohibited.

100.7 When a professional accountant identifies threats to compliance with the fundamental principles and, based on an evaluation of those threats, determines that they are not at an acceptable level, the professional accountant shall determine whether appropriate safeguards are available and can be applied to eliminate the threats or reduce them to an acceptable level. In making that determination, the professional accountant shall exercise professional judgment and take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at the time, would be likely to conclude that the threats would be eliminated or reduced to an acceptable level by the application of the safeguards, such that compliance with the fundamental principles is not compromised.

100.8 A professional accountant shall 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.

100.9 A professional accountant shall take qualitative as well as quantitative factors into account when evaluating the significance of a threat. When applying the conceptual framework, a professional accountant may encounter situations in which threats cannot be eliminated or reduced to an acceptable level, either because the threat is too significant or because appropriate safeguards are not available or cannot be applied. In such situations, the professional accountant shall decline or discontinue the specific professional activity or service involved or, when necessary, resign from the engagement (in the case of a professional accountant in public practice) or the employing organization (in the case of a professional accountant in business).

100.10 Sections 290 and 291 contain provisions with which a professional accountant shall comply if the professional accountant identifies a breach of an independence provision of the Code. If a professional accountant identifies a breach of any other provision of this Code, the professional accountant shall evaluate the significance of the breach and its impact on the accountant's ability to comply with the fundamental principles. The accountant shall take whatever actions that may be available, as soon as possible, to satisfactorily address the consequences of the breach. The accountant shall determine whether to report the breach, for example, to those who may have been affected by the breach, the Institute, relevant regulator or oversight authority.

100.11 When a professional accountant encounters unusual circumstances in which the application of a specific requirement of the Code would result in a disproportionate outcome or an outcome that may not be in the public interest, it is recommended that the professional accountant consult with the Institute or the relevant regulator.

Threats and Safeguards

100.12 Threats may be created by a broad range of relationships and circumstances. When a relationship or circumstance creates a threat, such a threat could compromise, or could be perceived to compromise, a professional accountant's compliance with the fundamental principles. A circumstance or relationship may create more than one threat, and a threat may affect compliance with more than one fundamental principle. Threats fall into one or more of the following categories:

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

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

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

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

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

Parts B and C of this Code explain how these categories of threats may be created for professional accountants in public practice and professional accountants in business, respectively. Professional accountants in public practice may also find Part C relevant to their particular circumstances.

100.13 Safeguards are actions or other measures that may eliminate threats or reduce them to an acceptable level. They fall into two broad categories:

(a) Safeguards created by the profession, legislation or regulation; and

(b) Safeguards in the work environment.

100.14 Safeguards created by the profession, legislation or regulation include:

- 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.

100.15 Parts B and C of this Code discuss safeguards in the work environment for professional accountants in public practice and professional accountants in business, respectively.

100.16 Certain safeguards may increase the likelihood of identifying or deterring unethical behavior. Such safeguards, which may be created by the accounting profession, legislation, regulation, or an employing organization, include:

- Effective, well-publicized complaint 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 behavior.
- An explicitly stated duty to report breaches of ethical requirements.

Conflicts of Interest

100.17 A professional accountant may be faced with a conflict of interest when undertaking a professional activity. A conflict of interest creates a threat to objectivity and may create threats to the other fundamental principles. Such threats may be created when:

- The professional accountant undertakes a professional activity related to a particular matter for two or more parties whose interests with respect to that matter are in conflict; or
- The interests of the professional accountant with respect to a particular matter and the interests of a party for whom the professional accountant undertakes a professional activity related to that matter are in conflict.

100.18 Parts B and C of this Code discuss conflicts of interest for professional accountants in public practice and professional accountants in business, respectively.

Ethical Conflict Resolution

100.19 A professional accountant may be required to resolve a conflict in complying with the fundamental principles.

100.20 When initiating either a formal or informal conflict resolution process, the following factors, either individually or together with other factors, may be relevant to 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 the relevant factors, a professional accountant shall determine the appropriate course of action, weighing the consequences of each possible course of action. If the matter remains unresolved, the professional accountant may wish to consult with other appropriate persons within the firm or employing organization for help in obtaining resolution.

100.21 Where a matter involves a conflict with, or within, an organization, a professional accountant shall determine whether to consult with those charged with governance of the organization, such as the board of directors or the audit committee.

100.22 It may be in the best interests of the professional accountant to document the substance of the issue, the details of any discussions held, and the decisions made concerning that issue.

100.23 If a significant conflict cannot be resolved, a professional accountant may consider obtaining professional advice from the relevant professional body or from legal advisors. The professional accountant generally can obtain guidance on ethical issues without breaching the fundamental principle of confidentiality if the matter is discussed with the

relevant professional body on an anonymous basis or with a legal advisor under the protection of legal privilege.

100.24 If, after exhausting all relevant possibilities, the ethical conflict remains unresolved, a professional accountant shall, unless prohibited by law, refuse to remain associated with the matter creating the conflict. The professional accountant shall determine whether, 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.

Communicating with Those Charged with Governance

100.25 When communicating with those charged with governance in accordance with the provisions of this Code, the professional accountant or firm shall determine, having regard to the nature and importance of the particular circumstances and matter to be communicated, the appropriate person(s) within the entity's governance structure with whom to communicate. If the professional accountant or firm communicates with a subgroup of those charged with governance, for example, an audit committee or an individual, the professional accountant or firm shall determine whether communication with all of those charged with governance is also necessary so that they are adequately informed.

100.26 In some cases, all of those charged with governance are involved in managing the entity, for example, a small business where a single owner manages the entity and no one else has a governance role. In these cases, if matters are communicated with person(s) with management responsibilities, and those person(s) also have governance responsibilities, the matters need not be communicated again with those same person(s) in their governance role. The professional accountant or firm shall nonetheless be satisfied that communication with person(s) with management responsibilities adequately informs all of those with whom the professional accountant or firm would otherwise communicate in their governance capacity.

SECTION 110

Integrity

110.1 The principle of integrity imposes an obligation on all professional accountants to be straightforward and honest in all professional and business relationships. Integrity also implies fair dealing and truthfulness.

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

When a professional accountant becomes aware that the accountant has been associated with such information, the accountant shall take steps to be disassociated from that information.

110.3 A professional accountant will be deemed not 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. A professional accountant shall not perform a professional activity or service if a circumstance or relationship biases or unduly influences the accountant's professional judgment with respect to that service.

SECTION 130

Professional Competence and Due Care

130.1 The principle of professional competence and due care imposes the following obligations on all 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 performing professional activities or 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 enables a professional accountant to develop and maintain the capabilities to perform competently within the professional environment.

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 shall take reasonable 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 shall make clients, employers or other users of the accountant's professional services or activities aware of the limitations inherent in the services or activities.

SECTION 140

Confidentiality

140.1 The principle of confidentiality imposes an obligation on all 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 shall maintain confidentiality, including in a social environment, being alert to the possibility of inadvertent disclosure, particularly to a close business associate or a close or immediate family member.

140.3 A professional accountant shall maintain confidentiality of information disclosed by a prospective client or employer.

140.4 A professional accountant shall maintain confidentiality of information within the firm or employing organization.

140.5 A professional accountant shall take 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 shall not, however, use or disclose any confidential information either acquired or received as a result of a professional or business relationship.

140.7 As a fundamental principle, confidentiality serves the public interest because it facilitates the free flow of information from the professional accountant's client or employing organization to the professional accountant. Nevertheless, 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 the Institute or professional body;

(ii) To respond to an inquiry or investigation by the Institute or regulatory body;

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

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

140.8 In deciding whether to disclose confidential information, relevant factors to consider include:

(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 shall be used in determining the type of disclosure to be made, if any;

(c) The type of communication that is expected and to whom it is addressed; and

(d) Whether 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 Behavior

150.1 The principle of professional behavior imposes an obligation on all professional accountants to comply with relevant laws and regulations and avoid any conduct that the professional accountant knows or should know may discredit the profession. This includes conduct that a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at that time, would be likely to conclude adversely affects the good reputation of the profession.

150.2 In marketing and promoting themselves and their work, professional accountants shall not bring the profession into disrepute. Professional accountants shall be honest and truthful and 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

	Pages
Section 200 Introduction	19-22
Section 210 Professional Appointment	23-25
Section 220 Conflicts of Interest	26-29
Section 225 Responding to Non-Compliance with Laws and Regulations	30-39
Section 230 Second Opinions	40
Section 240 Fees and Other Types of Remuneration	41-42
Section 250 Marketing Professional Services	43
Section 260 Gifts and Hospitality	44
Section 270 Custody of Client Assets	45
Section 280 Objectivity – All Services	46
Section 290 Independence – Audit and Review Engagements	47-86
Section 291 Independence – Other Assurance Engagements	87-108

SECTION 200

Introduction

200.1 This Part of the Code describes how the conceptual framework contained in Part A applies in certain situations to professional accountants in public practice. This Part does not describe all of the circumstances and relationships that could be encountered by a professional accountant in public practice that create or may create threats to compliance with the fundamental principles. Therefore, the professional accountant in public practice is encouraged to be alert for such circumstances and relationships.

200.2 A professional accountant in public practice shall not knowingly 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 fundamental principles.

Threats and Safeguards

200.3 Compliance with the fundamental principles may potentially be threatened by a broad range of circumstances and relationships. The nature and significance of the threats may differ depending on whether they arise in relation to the provision of services to an audit client and whether the audit client is a public interest entity, to an assurance client that is not an audit client, or to a non-assurance client.

Threats fall into one or more of the following categories:

(a) Self-interest;

(b) Self-review;

(c) Advocacy;

(d) Familiarity; and

(e) Intimidation.

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

200.4 Examples of circumstances that create self-interest threats for a professional accountant in public practice include:

- A member of the assurance team having a direct financial interest in the assurance client.
- A firm having undue dependence on total fees from a client.
- A member of the assurance team having a significant close business relationship with an assurance client.
- A firm being concerned about the possibility of losing a significant client.
- A member of the audit team entering into employment negotiations with the audit client.
- A firm entering into a contingent fee arrangement relating to an assurance engagement.
- A professional accountant discovering a significant error when evaluating the results of a previous professional service performed by a member of the professional accountant's firm.

200.5 Examples of circumstances that create self-review threats for a professional accountant in public practice include:

- A firm issuing an assurance report on the effectiveness of the operation of financial systems after designing or implementing the systems.
- A firm having prepared the original data used to generate records that are the subject matter of the assurance engagement.
- A member of the assurance team being, or having recently been, a director or officer of the client.
- A member of the assurance team being, or having recently been, employed by the client in a position to exert significant influence over the subject matter of the engagement.
- The firm performing a service for an assurance client that directly affects the subject matter information of the assurance engagement.

200.6 Examples of circumstances that create advocacy threats for a professional accountant in public practice include:

- The firm promoting shares in an audit client.
- A professional accountant acting as an advocate on behalf of an audit client in litigation or disputes with third parties.

200.7 Examples of circumstances that create familiarity threats for a professional accountant in public practice include:

- A member of the engagement team having a close or immediate family member who is a director or officer of the client.
- A member of the engagement team having a close or immediate family member who is an employee of the client who is in a position to exert significant influence over the subject matter of the engagement.
- A director or officer of the client or an employee in a position to exert significant influence over the subject matter of the engagement having recently served as the engagement partner.
- A professional accountant accepting gifts or preferential treatment from a client, unless the value is trivial or inconsequential.
- Senior personnel having a long association with the assurance client.

200.8 Examples of circumstances that create intimidation threats for a professional accountant in public practice include:

- A firm being threatened with dismissal from a client engagement.
- An audit client indicating that it will not award a planned non-assurance contract to the firm if the firm continues to disagree with the client's accounting treatment for a particular transaction.
- A firm being threatened with litigation by the client.
- A firm being pressured to reduce inappropriately the extent of work performed in order to reduce fees.
- A professional accountant feeling pressured to agree with the judgment of a client employee because the employee has more expertise on the matter in question.
- A professional accountant being informed by a partner of the firm that a planned promotion will not occur unless the accountant agrees with an audit client's inappropriate accounting treatment.

200.9 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 100.14 of Part A of this Code.

200.10 A professional accountant in public practice shall exercise judgment to determine how best to deal with threats that are not at an acceptable level, whether by applying safeguards to eliminate the threat or reduce it to an acceptable level or by terminating or declining the relevant engagement. In exercising this judgment, a professional accountant in public practice shall consider whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at that time, would be likely to conclude that the threats would be eliminated or reduced to an acceptable level by the application of safeguards, such that compliance with the fundamental principles is not compromised. This consideration will be affected by matters such as the significance of the threat, the nature of the engagement and the structure of the firm.

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.

200.12 Examples of firm-wide safeguards in the work environment 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 need to identify threats to compliance with the fundamental principles, evaluate the significance of those threats, and apply safeguards to eliminate or reduce the threats to an acceptable level or, when appropriate safeguards are not available or cannot be applied, terminate or decline the relevant engagement.
- Documented internal policies and procedures requiring compliance with the fundamental principles.
- 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 assurance clients and related entities from which independence is required.

- 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 Examples of engagement-specific safeguards in the work environment include:

- Having a professional accountant who was not involved with the non-assurance service review the non-assurance work performed or otherwise advise as necessary.
- Having a professional accountant who was not a member of the assurance team review the assurance work performed 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 Examples of safeguards within the client's systems and procedures include:

- The client requires persons other than management to ratify or approve the appointment of a firm to perform an engagement.
- The client has competent employees with experience and seniority to make managerial decisions.
- The client has implemented internal procedures that 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 and Continuance

210.1 Before accepting a new client relationship, a professional accountant in public practice shall determine whether acceptance would create any threats to compliance with the fundamental principles. Potential threats to integrity or professional behavior may be created from, for example, issues associated with the client (its owners, management or activities) that, if known, could threaten compliance with the fundamental principles. These include, for example, client involvement in illegal activities (such as money laundering), dishonesty, questionable financial reporting practices or other unethical behavior.

210.2 A professional accountant in public practice shall evaluate the significance of any threats and apply safeguards when necessary to eliminate them or reduce them to an acceptable level.

Examples of such safeguards 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 address the questionable issues, for example, through improving corporate governance practices or internal controls.

210.3 Where it is not possible to reduce the threats to an acceptable level, the professional accountant in public practice shall decline to enter into the client relationship.

210.4 Potential threats to compliance with the fundamental principles may have been created after acceptance that would have caused the professional accountant to decline the engagement had that information been available earlier. A professional accountant in public practice shall, therefore, periodically review whether to continue with a recurring client engagement. For example, a threat to compliance with the fundamental principles may be created by a client's unethical behavior such as improper earnings management or balance sheet valuations. If a professional accountant in public practice identifies a threat to compliance with the fundamental principles, the professional accountant shall evaluate the significance of the threats and apply safeguards when necessary to eliminate the threat or reduce it to an acceptable level. Where it is not possible to reduce the threat to an acceptable level, the professional accountant in public practice shall consider terminating the client relationship where termination is not prohibited by law or regulation.

Engagement Acceptance

210.5 The fundamental principle of professional competence and due care imposes an obligation on a professional accountant in public practice 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 shall determine 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.

210.6 A professional accountant in public practice shall evaluate the significance of threats and apply safeguards, when necessary, to eliminate them or reduce them to an acceptable level. Examples of such safeguards 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; or
- Complying with quality control policies and procedures designed to provide reasonable assurance that specific engagements are accepted only when they can be performed competently.

210.7 When a professional accountant in public practice intends to rely on the advice or work of an expert, the professional accountant in public practice shall determine whether such reliance is warranted. Factors to consider include: 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

210.8 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, shall determine whether there are any reasons, professional or otherwise, for not accepting the engagement, such as circumstances that create threats to compliance with the fundamental principles that cannot be eliminated or reduced to an acceptable level by the application of safeguards. 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.

210.9 A professional accountant in public practice shall evaluate the significance of any threats. Safeguards shall be applied when necessary to eliminate any threats or reduce them to an acceptable level. Examples of such safeguards include:

- When replying to requests to submit tenders, stating in the tender that, before accepting the engagement, contact with the existing or predecessor 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;
- Asking the predecessor accountant to provide known information on any facts or circumstances that, in the predecessor accountant's opinion, the proposed successor accountant needs to be aware of before deciding whether 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 predecessor accountant that may influence the decision to accept the appointment; or
- Obtaining necessary information from other sources.

210.10 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 create threats to professional competence and due care resulting from, for example, a lack of or incomplete information. The significance of any threats shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. An example of such a safeguard is 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.

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

Circumstances where the professional accountant is or may be required to disclose confidential information or where such disclosure may otherwise be appropriate are set out in Section 140 of Part A of this Code.

210.12 A professional accountant in public practice will generally need to obtain the client's permission, preferably in writing, to initiate discussion with an existing or predecessor accountant. Once that permission is obtained, the existing or predecessor accountant shall comply with relevant laws and regulations governing such requests. Where the existing or predecessor accountant provides information, it shall be provided honestly and unambiguously. If the proposed accountant is unable to communicate with the existing or predecessor accountant, the proposed accountant shall take reasonable steps to obtain information about any possible threats by other means, such as through inquiries of third parties or background investigations of senior management or those charged with governance of the client.

210.13 In the case of an audit of financial statements, a professional accountant shall request the predecessor accountant to provide known information regarding any facts or other information that, in the predecessor accountant's opinion, the proposed successor accountant needs to be aware of before deciding whether to accept the engagement. Except for the circumstances involving identified or suspected non-compliance with laws and regulations set out in paragraph 225.31:

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

(b) If the client fails or refuses to grant the predecessor accountant permission to discuss the client's affairs with the proposed successor accountant, the predecessor accountant shall disclose this fact to the proposed successor accountant, who shall carefully consider such failure or refusal when determining whether or not to accept the appointment.

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 may be faced with a conflict of interest when performing a professional service. A conflict of interest creates a threat to objectivity and may create threats to the other fundamental principles. Such threats may be created when:

- The professional accountant provides a professional service related to a particular matter for two or more clients whose interests with respect to that matter are in conflict; or
- The interests of the professional accountant with respect to a particular matter and the interests of the client for whom the professional accountant provides a professional service related to that matter are in conflict.

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

When the professional service is an assurance service, compliance with the fundamental principle of objectivity also requires being independent of assurance clients in accordance with Sections 290 or 291 as appropriate.

220.2 Examples of situations in which conflicts of interest may arise include:

- Providing a transaction advisory service to a client seeking to acquire an audit client of the firm, where the firm has obtained confidential information during the course of the audit that may be relevant to the transaction.
- Advising two clients at the same time who are competing to acquire the same company where the advice might be relevant to the parties' competitive positions.
- Providing services to both a vendor and a purchaser in relation to the same transaction.
- Preparing valuations of assets for two parties who are in an adversarial position with respect to the assets.
- Representing two clients regarding the same matter who are in a legal dispute with each other, such as during divorce proceedings or the dissolution of a partnership.
- Providing an assurance report for a licensor on royalties due under a license agreement when at the same time advising the licensee of the correctness of the amounts payable.
- Advising a client to invest in a business in which, for example, the spouse of the professional accountant in public practice has a financial interest.
- Providing strategic advice to a client on its competitive position while having a joint venture or similar interest with a major competitor of the client.
- Advising a client on the acquisition of a business which the firm is also interested in acquiring.
- Advising a client on the purchase of a product or service while having a royalty or commission agreement with one of the potential vendors of that product or service.

220.3 When identifying and evaluating the interests and relationships that might create a conflict of interest and implementing safeguards, when necessary, to eliminate or reduce any threat to compliance with the fundamental principles to an acceptable level, a professional accountant in public practice shall exercise professional judgment and take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at the time, would be likely to conclude that compliance with the fundamental principles is not compromised.

220.4 When addressing conflicts of interest, including making disclosures or sharing information within the firm or network and seeking guidance of third parties, the professional accountant in public practice shall remain alert to the fundamental principle of confidentiality.

220.5 If the threat created by a conflict of interest is not at an acceptable level, the professional accountant in public practice shall apply safeguards to eliminate the threat or reduce it to an acceptable level. If safeguards cannot reduce the threat to an acceptable level, the professional accountant shall decline to perform or shall discontinue professional services that would result in the conflict of interest; or shall terminate relevant relationships or dispose of relevant interests to eliminate the threat or reduce it to an acceptable level.

220.6 Before accepting a new client relationship, engagement, or business relationship, a professional accountant in public practice shall take reasonable steps to identify circumstances that might create a conflict of interest, including identification of:

- The nature of the relevant interests and relationships between the parties involved; and
- The nature of the service and its implication for relevant parties.

The nature of the services and the relevant interests and relationships may change during the course of the engagement. This is particularly true when a professional accountant is asked to conduct an engagement in a situation that may become adversarial, even though the parties who engage the professional accountant may not initially be involved in a dispute. The professional accountant shall remain alert to such changes for the purpose of identifying circumstances that might create a conflict of interest.

220.7 For the purpose of identifying interests and relationships that might create a conflict of interest, having an effective conflict identification process assists a professional accountant in public practice to identify actual or potential conflicts of interest prior to determining whether to accept an engagement and throughout an engagement. This includes matters identified by external parties, for example clients or potential clients. The earlier an actual or potential conflict of interest is identified, the greater the likelihood of the professional accountant being able to apply safeguards, when necessary, to eliminate the threat to objectivity and any threat to compliance with other fundamental principles or reduce it to an acceptable level. The process to identify actual or potential conflicts of interest will depend on such factors as:

- The nature of the professional services provided.
- The size of the firm.
- The size and nature of the client base.
- The structure of the firm, for example, the number and geographic location of offices.

220.8 If the firm is a member of a network, conflict identification shall include any conflicts of interest that the professional accountant in public practice has reason to believe may exist or might arise due to interests and relationships of a network firm. Reasonable steps to identify such interests and relationships involving a network firm will depend on factors such as the nature of the professional services provided, the clients served by the network and the geographic locations of all relevant parties.

220.9 If a conflict of interest is identified, the professional accountant in public practice shall evaluate:

- The significance of relevant interests or relationships; and
- The significance of the threats created by performing the professional service or services. In general, the more direct the connection between the professional service and the matter on which the parties' interests are in conflict, the more significant the threat to objectivity and compliance with the other fundamental principles will be.

220.10 The professional accountant in public practice shall apply safeguards, when necessary, to eliminate the threats to compliance with the fundamental principles created by the conflict of interest or reduce them to an acceptable level. Examples of safeguards include:

- Implementing mechanisms to prevent unauthorized disclosure of confidential information when performing professional services related to a particular matter for two or more clients whose interests with respect to that matter are in conflict. This could include:
    - Using separate engagement teams who are provided with clear policies and procedures on maintaining confidentiality.
    - Creating separate areas of practice for specialty functions within the firm, which may act as a barrier to the passing of confidential client information from one practice area to another within a firm.
    - Establishing policies and procedures to limit access to client files, the use of confidentiality agreements signed by employees and partners of the firm and/or the physical and electronic separation of confidential information.
- Regular review of the application of safeguards by a senior individual not involved with the client engagement or engagements.
- Having a professional accountant who is not involved in providing the service or otherwise affected by the conflict, review the work performed to assess whether the key judgments and conclusions are appropriate.
- Consulting with third parties, such as a professional body, legal counsel or another professional accountant.

220.11 In addition, it is generally necessary to disclose the nature of the conflict of interest and the related safeguards, if any, to clients affected by the conflict and, when safeguards are required to reduce the threat to an acceptable level, to obtain their consent to the professional accountant in public practice performing the professional services. Disclosure and consent may take different forms, for example:

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

The professional accountant shall determine whether the nature and significance of the conflict of interest is such that specific disclosure and explicit consent is necessary. For this purpose, the professional accountant shall exercise professional judgment in weighing the outcome of the evaluation of the circumstances that create a conflict of interest, including the parties that might be affected, the nature of the issues that might arise and the potential for the particular matter to develop in an unexpected manner.

220.12 Where a professional accountant in public practice has requested explicit consent from a client and that consent has been refused by the client, the professional accountant shall decline to perform or shall discontinue professional services that would result in the conflict of interest; or shall terminate relevant relationships or dispose of relevant interests to eliminate the threat or reduce it to an acceptable level, such that consent can be obtained, after applying any additional safeguards if necessary.

220.13 When disclosure is verbal, or consent is verbal or implied, the professional accountant in public practice is encouraged to document the nature of the circumstances giving rise to the conflict of interest, the safeguards applied to reduce the threats to an acceptable level and the consent obtained.

220.14 In certain circumstances, making specific disclosure for the purpose of obtaining explicit consent would result in a breach of confidentiality. Examples of such circumstances may include:

- Performing a transaction-related service for a client in connection with a hostile takeover of another client of the firm.
- Performing a forensic investigation for a client in connection with a suspected fraudulent act where the firm has confidential information obtained through having performed a professional service for another client who might be involved in the fraud.

The firm shall not accept or continue an engagement under such circumstances unless the following conditions are met:

- The firm does not act in an advocacy role for one client where this requires the firm to assume an adversarial position against the other client with respect to the same matter;
- Specific mechanisms are in place to prevent disclosure of confidential information between the engagement teams serving the two clients; and
- The firm is satisfied that a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant in public practice at the time, would be likely to conclude that it is appropriate for the firm to accept or continue the engagement because a restriction on the firm's ability to provide the service would produce a disproportionate adverse outcome for the clients or other relevant third parties.

The professional accountant shall document the nature of the circumstances, including the role that the professional accountant is to undertake, the specific mechanisms in place to prevent disclosure of information between the engagement teams serving the two clients and the rationale for the conclusion that it is appropriate to accept the engagement.

Section 225

Responding to Non-Compliance with Laws and Regulations

Purpose

225.1 A professional accountant in public practice may encounter or be made aware of non-compliance or suspected non-compliance with laws and regulations in the course of providing a professional service to a client. The purpose of this section is to set out the professional accountant's responsibilities when encountering such non-compliance or suspected non-compliance, and guide the professional accountant in assessing the implications of the matter and the possible courses of action when responding to it. This section applies regardless of the nature of the client, including whether or not it is a public interest entity.

225.2 Non-compliance with laws and regulations ("non-compliance") comprises acts of omission or commission, intentional or unintentional, committed by a client, or by those charged with governance, by management or by other individuals working for or under the direction of a client which are contrary to the prevailing laws or regulations.

225.3 In some jurisdictions, there are legal or regulatory provisions governing how professional accountants should address non-compliance or suspected non-compliance which may differ from or go beyond this section. When encountering such non-compliance or suspected non-compliance, the professional accountant has a responsibility to obtain an understanding of those provisions and comply with them, including any requirement to report the matter to an appropriate authority and any prohibition on alerting the client prior to making any disclosure, for example, pursuant to anti-money laundering legislation.

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

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

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

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

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

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

Scope

225.5 This section sets out the approach to be taken by a professional accountant who encounters or is made aware of non-compliance or suspected non-compliance with:

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

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

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

- Fraud, corruption and bribery.
- Money laundering, terrorist financing and proceeds of crime.
- Securities markets and trading.

- Banking and other financial products and services.
- Data protection.
- Tax and pension liabilities and payments.
- Environmental protection.
- Public health and safety.

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

225.8 A professional accountant who encounters or is made aware of matters that are clearly inconsequential, judged by their nature and their impact, financial or otherwise, on the client, its stakeholders and the general public, is not required to comply with this section with respect to such matters.

225.9 This section does not address:

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

(b) Non-compliance other than by the client or those charged with governance, management or other individuals working for or under the direction of the client. This includes, for example, circumstances where a professional accountant has been engaged by a client to perform a due diligence assignment on a third party entity and the identified or suspected non-compliance has been committed by that third party.

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

Responsibilities of the Client's Management and Those Charged with Governance

225.10 It is the responsibility of the client's management, with the oversight of those charged with governance, to ensure that the client's business activities are conducted in accordance with laws and regulations. It is also the responsibility of management and those charged with governance to identify and address any non-compliance by the client, by an individual charged with governance of the entity, by a member of management, or by other individuals working for or under the direction of the client.

Responsibilities of Professional Accountants in Public Practice

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

Audits of Financial Statements

Obtaining an Understanding of the Matter

225.12 If a professional accountant engaged to perform an audit of financial statements becomes aware of information concerning an instance of non-compliance or suspected non-compliance, whether in the course of performing the engagement or through information provided by other parties, the professional accountant shall obtain an understanding of the

matter, including the nature of the act and the circumstances in which it has occurred or may occur.

225.13 The professional accountant is expected to apply knowledge, professional judgment and expertise, but is not expected to have a level of knowledge of laws and regulations that is greater than that which is required to undertake the engagement. Whether an act constitutes non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body. Depending on the nature and significance of the matter, the professional accountant may consult on a confidential basis with others within the firm, a network firm or a professional body, or with legal counsel.

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

225.15 Such discussion serves to clarify the professional accountant's understanding of the facts and circumstances relevant to the matter and its potential consequences. The discussion also may prompt management or those charged with governance to investigate the matter.

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

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

225.17 The appropriate level of management is generally at least one level above the person or persons involved or potentially involved in the matter. If the professional accountant believes that management is involved in the non-compliance or suspected non-compliance, the professional accountant shall discuss the matter with those charged with governance. The professional accountant may also consider discussing the matter with internal auditors, where applicable. In the context of a group, the appropriate level may be management at an entity that controls the client.

Addressing the Matter

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

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

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

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

225.19 The professional accountant shall consider whether the client's management and those charged with governance understand their legal or regulatory responsibilities with respect to the non-compliance or suspected non-compliance. If not, the professional accountant may suggest appropriate sources of information or recommend that they obtain legal advice.

225.20 The professional accountant shall comply with applicable:

(a) Laws and regulations, including legal or regulatory provisions governing the reporting of non-compliance or suspected non-compliance to an appropriate authority. In this regard, some laws and regulations may stipulate a period within which reports are to be made; and

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

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

Communication with Respect to Groups

225.21 A professional accountant may:

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

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

Where the professional accountant becomes aware of non-compliance or suspected non-compliance in relation to the component in either situation, the professional accountant shall, in addition to responding to the matter in accordance with the provisions of this section, communicate it to the group engagement partner unless prohibited from doing so by law or regulation. This is to enable the group engagement partner to be informed about the matter and to determine, in the context of the group audit, whether and, if so, how it should be addressed in accordance with the provisions in this section.

225.22 Where the group engagement partner becomes aware of non-compliance or suspected non-compliance in the course of an audit of group financial statements, including as a result of being informed of such a matter in accordance with paragraph 225.21, the group engagement partner shall, in addition to responding to the matter in the context of the group audit in accordance with the provisions of this section, consider whether the matter may be relevant to one or more components:

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

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

If so, the group engagement partner shall take steps to have the non-compliance or suspected non-compliance communicated to those performing work at components where the matter may be relevant, unless prohibited from doing so by law or regulation. If necessary in relation to subparagraph (b), appropriate inquiries shall be made (either of management or from publicly available information) as to whether the relevant component(s) is subject to audit and, if so, to ascertain to the extent practicable the identity of the auditor. The communication is to enable those responsible for work at such components to be informed about the matter and to determine whether and, if so, how it should be addressed in accordance with the provisions in this section.

Determining Whether Further Action Is Needed

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

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

- The response is timely.
- The non-compliance or suspected non-compliance has been adequately investigated.
- Action has been, or is being, taken to rectify, remediate or mitigate the consequences of any non-compliance.

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

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

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

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

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

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

225.28 In determining the need for, and nature and extent of, further action, the professional accountant shall exercise professional judgment and take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at the time, would be likely to conclude that the professional accountant has acted appropriately in the public interest.

225.29 Further action by the professional accountant may include:

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

225.30 Where the professional accountant determines that withdrawing from the engagement and the professional relationship would be appropriate, doing so would not be a substitute for taking other actions that may be needed to achieve the professional accountant's objectives under this section. In some jurisdictions, however, there may be limitations as to the further actions available to the professional accountant and withdrawal may be the only available course of action.

225.31 Where the professional accountant has withdrawn from the professional relationship pursuant to paragraphs 225.25 and 225.29, the professional accountant shall, on request

by the proposed successor accountant, provide all such facts and other information concerning the identified or suspected non-compliance that, in the predecessor accountant's opinion, the proposed successor accountant needs to be aware of before deciding whether to accept the audit appointment. The predecessor accountant shall do so despite paragraph 210.14, unless prohibited by law or regulation. If the proposed successor accountant is unable to communicate with the predecessor accountant, the proposed successor accountant shall take reasonable steps to obtain information about the circumstances of the change of appointment by other means, such as through inquiries of third parties or background investigations of management or those charged with governance.

225.32 As consideration of the matter may involve complex analysis and judgments, the professional accountant may consider consulting internally, obtaining legal advice to understand the professional accountant's options and the professional or legal implications of taking any particular course of action, or consulting on a confidential basis with a regulator or professional body.

Determining Whether to Disclose the Matter to an Appropriate Authority

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

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

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

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

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

225.35 If the professional accountant determines that disclosure of the non-compliance or suspected non-compliance to an appropriate authority is an appropriate course of action in the circumstances, this will not be considered a breach of the duty of confidentiality under

Section 140 of this Code. When making such disclosure, the professional accountant shall act in good faith and exercise caution when making statements and assertions. The professional accountant shall also consider whether it is appropriate to inform the client of the professional accountant's intentions before disclosing the matter.

225.36 In exceptional circumstances, the professional accountant may become aware of actual or intended conduct that the professional accountant has reason to believe would constitute an imminent breach of a law or regulation that would cause substantial harm to investors, creditors, employees or the general public. Having considered whether it would be appropriate to discuss the matter with management or those charged with governance of the entity, the professional accountant shall exercise professional judgment and may immediately disclose the matter to an appropriate authority in order to prevent or mitigate the consequences of such imminent breach of law or regulation. Such disclosure will not be considered a breach of the duty of confidentiality under Section 140 of this Code.

Documentation

225.37 In relation to an identified or suspected act of non-compliance that falls within the scope of this section, the professional accountant shall, in addition to complying with the documentation requirements under applicable auditing standards, document:

- How management and, where applicable, those charged with governance have responded to the matter.
- The courses of action the professional accountant considered, the judgments made and the decisions that were taken, having regard to the reasonable and informed third party perspective.
- How the professional accountant is satisfied that the professional accountant has fulfilled the responsibility set out in paragraph 225.25.

225.38 International Standards on Auditing (ISAs), for example, require a professional accountant performing an audit of financial statements to:

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

Professional Services Other than Audits of Financial Statements

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

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

225.40 The professional accountant is expected to apply knowledge, professional judgment and expertise, but is not expected to have a level of understanding of laws and regulations beyond that which is required for the professional service for which the accountant was engaged. Whether an act constitutes actual non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body. Depending on the nature and significance of the matter, the professional accountant may consult on a confidential basis with others within the firm, a network firm or a professional body, or with legal counsel.

225.41 If the professional accountant identifies or suspects that non-compliance has occurred or may occur, the professional accountant shall discuss the matter with the appropriate level of management and, if the professional accountant has access to them and where appropriate, those charged with governance.

225.42 Such discussion serves to clarify the professional accountant's understanding of the facts and circumstances relevant to the matter and its potential consequences. The discussion also may prompt management or those charged with governance to investigate the matter.

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

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

Communicating the Matter to the Entity's External Auditor

225.44 If the professional accountant is performing a non-audit service for an audit client of the firm, or a component of an audit client of the firm, the professional accountant shall communicate the non-compliance or suspected non-compliance within the firm, unless prohibited from doing so by law or regulation. The communication shall be made in accordance with the firm's protocols or procedures or, in the absence of such protocols and procedures, directly to the audit engagement partner.

225.45 If the professional accountant is performing a non-audit service for an audit client of a network firm, or a component of an audit client of a network firm, the professional accountant shall consider whether to communicate the non-compliance or suspected non-compliance to the network firm. Where the communication is made, it shall be made in accordance with the network's protocols or procedures or, in the absence of such protocols and procedures, directly to the audit engagement partner.

225.46 If the professional accountant is performing a non-audit service for a client that is not:

(a) An audit client of the firm or a network firm; or

(b) A component of an audit client of the firm or a network firm,

the professional accountant shall consider whether to communicate the non-compliance or suspected non-compliance to the firm that is the client's external auditor, if any.

225.47 Factors relevant to considering the communication in accordance with paragraphs 225.45 and 225.46 include:

- Whether doing so would be contrary to law or regulation.
- Whether there are restrictions about disclosure imposed by a regulatory agency or prosecutor in an ongoing investigation into the non-compliance or suspected non-compliance.
- Whether the purpose of the engagement is to investigate potential non-compliance within the entity to enable it to take appropriate action.
- Whether management or those charged with governance have already informed the entity's external auditor about the matter.
- The likely materiality of the matter to the audit of the client's financial statements or, where the matter relates to a component of a group, its likely materiality to the audit of the group financial statements.

225.48 In all cases, the communication is to enable the audit engagement partner to be informed about the non-compliance or suspected non-compliance and to determine whether and, if so, how it should be addressed in accordance with the provisions of this section.

Considering Whether Further Action Is Needed

225.49 The professional accountant shall also consider whether further action is needed in the public interest.

225.50 Whether further action is needed, and the nature and extent of it, will depend on factors such as:

- The legal and regulatory framework.
- The appropriateness and timeliness of the response of management and, where applicable, those charged with governance.
- The urgency of the matter.
- The involvement of management or those charged with governance in the matter.
- The likelihood of substantial harm to the interests of the client, investors, creditors, employees or the general public.

225.51 Further action by the professional accountant may include:

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

225.52 In considering whether to disclose to an appropriate authority, relevant factors to take into account include:

- Whether doing so would be contrary to law or regulation.
- Whether there are restrictions about disclosure imposed by a regulatory agency or prosecutor in an ongoing investigation into the non-compliance or suspected non-compliance.
- Whether the purpose of the engagement is to investigate potential non-compliance within the entity to enable it to take appropriate action.

225.53 If the professional accountant determines that disclosure of the non-compliance or suspected non-compliance to an appropriate authority is an appropriate course of action in

the circumstances, this will not be considered a breach of the duty of confidentiality under Section 140 of this Code. When making such disclosure, the professional accountant shall act in good faith and exercise caution when making statements and assertions. The professional accountant shall also consider whether it is appropriate to inform the client of the professional accountant's intentions before disclosing the matter.

225.54 In exceptional circumstances, the professional accountant may become aware of actual or intended conduct that the professional accountant has reason to believe would constitute an imminent breach of a law or regulation that would cause substantial harm to investors, creditors, employees or the general public. Having considered whether it would be appropriate to discuss the matter with management or those charged with governance of the entity, the professional accountant shall exercise professional judgment and may immediately disclose the matter to an appropriate authority in order to prevent or mitigate the consequences of such imminent breach of law or regulation. Such disclosure will not be considered a breach of the duty of confidentiality under Section 140 of this Code.

225.55 The professional accountant may consider consulting internally, obtaining legal advice to understand the professional or legal implications of taking any particular course of action, or consulting on a confidential basis with a regulator or professional body.

Documentation

225.56 In relation to an identified or suspected act of non-compliance that falls within the scope of this section, the professional accountant is encouraged to document:

- The matter.
- The results of discussion with management and, where applicable, those charged with governance and other parties.
- How management and, where applicable, those charged with governance have responded to the matter.
- The courses of action the professional accountant considered, the judgments made and the decisions that were taken.
- How the professional accountant is satisfied that the professional accountant has fulfilled the responsibility set out in paragraph 225.49.

Additional requirements are set out in Section 410 "Unlawful Acts or Defaults by Clients of Members".

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 create 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 existence and significance of any 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 shall evaluate the significance of any threats and apply safeguards when necessary to eliminate them or reduce them to an acceptable level. Examples of such safeguards 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 shall determine 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 is deemed 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 existence and significance of any threats created will depend on factors such as the level of fee quoted and the services to which it applies. The significance of any threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:

- 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, create threats to compliance with the fundamental principles in certain circumstances. They may create a self-interest threat to objectivity. The existence and 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 any such threats shall be evaluated and safeguards applied when necessary to eliminate or reduce them to an acceptable level. Examples of such safeguards 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 independent third party of the work performed by the professional accountant in public practice.

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 creates a self-interest threat to objectivity and professional competence and due care.

[1] Contingent fees for non-assurance services provided to audit clients and other assurance clients are discussed in Sections 290 and 291 of this part of the Code.

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 also creates a self-interest threat to objectivity and professional competence and due care.

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

- 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.

240.7A Members should note that under the Prevention of Bribery Ordinance[1a], there are provisions governing acceptance of any payment by someone who is in an agent-principal relationship with another person. For example, if an agent receives payment from another for doing something or showing favour to another in relation to the affairs or business of the agent's principal (who may be the agent's employer or in some other relationships with the agent which involve trust and confidence), the permission of the principal should be obtained first before receiving the payment in order to avoid the risk of contravening the Prevention of Bribery Ordinance.

The same principle applies to someone who is paying another person who is in an agent-principal relationship with some other person: the payer should ensure that the agent has obtained permission from his principal for receiving the payment.

Whether an agent-principal relationship exists in any given situation depends on the facts of each case. Members should consult their own legal advisors as and when necessary.

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 paragraphs 240.5–240.7 above.

[1a] Additional guidance on the Prevention of Bribery Ordinance (POBO) is available on the ICAC's website: http://www.icac.org.hk/en/law_enforcement/acl/index.html. Members may use the sample code of conduct based on the POBO in Appendix 1 provided by the ICAC for the private sector as a reference.

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 a threat to compliance with the fundamental principles. For example, a self-interest threat to compliance with the principle of professional behavior 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 shall not bring the profession into disrepute when marketing professional services. The professional accountant in public practice shall be honest and truthful and not:

(a) Make exaggerated claims for services offered, qualifications possessed, or experience gained; or

(b) Make disparaging references or unsubstantiated comparisons to the work of another.

If the professional accountant in public practice is in doubt about whether a proposed form of advertising or marketing is appropriate, the professional accountant in public practice shall consider consulting with the relevant professional body.

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

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 may create threats to compliance with the fundamental principles. For example, a self-interest or familiarity threat to objectivity may be created if a gift from a client is accepted; an intimidation threat to objectivity may result from the possibility of such offers being made public.

260.2 The existence and significance of any threat will depend on the nature, value, and intent of the offer. Where gifts or hospitality are offered that a reasonable and informed third party, weighing all the specific facts and circumstances, would consider trivial and inconsequential, 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 any threat to compliance with the fundamental principles is at an acceptable level.

260.3 A professional accountant in public practice shall evaluate the significance of any threats and apply safeguards when necessary to eliminate the threats or reduce them to an acceptable level. When the threats cannot be eliminated or reduced to an acceptable level through the application of safeguards, a professional accountant in public practice shall not accept such an offer.

SECTION 270

Custody of Client Assets

270.1 A professional accountant in public practice shall 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 behavior and may be a self interest threat to objectivity arising from holding client assets. A professional accountant in public practice entrusted with money (or other assets) belonging to others shall therefore:

(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 As part of client and engagement acceptance procedures for services that may involve the holding of client assets, a professional accountant in public practice shall make appropriate inquiries about the source of such assets and consider legal and regulatory obligations. For example, if the assets were derived from illegal activities, such as money laundering, a threat to compliance with the fundamental principles would be created. In such situations, the professional accountant shall comply with the provisions of section 225.

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

SECTION 280

Objectivity—All Services

280.1 A professional accountant in public practice shall determine 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 its 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 shall 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. Sections 290 and 291 provide specific guidance on independence requirements for professional accountants in public practice when performing assurance engagements.

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 shall evaluate the significance of any threats and apply safeguards when necessary to eliminate them or reduce them to an acceptable level. Examples of such safeguards 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.

If safeguards cannot eliminate or reduce the threat to an acceptable level, the professional accountant shall decline or terminate the relevant engagement.

SECTION 290
INDEPENDENCE—AUDIT AND REVIEW ENGAGEMENTS
CONTENTS

	Paragraph
Structure of Section	290.1
A Conceptual Framework Approach to Independence	290.4
Networks and Network Firms	290.13
Public Interest Entities	290.25
Related Entities	290.27
Those Charged with Governance	290.28
Documentation	290.29
Engagement Period	290.30
Mergers and Acquisitions	290.33
Breach of a Provision of this Section	290.39
Application of the Conceptual Framework Approach to Independence	290.100
Financial Interests	290.102
Loans and Guarantees	290.117
Business Relationships	290.123
Family and Personal Relationships	290.126
Employment with an Audit Client	290.132
Temporary Staff Assignments	290.140
Recent Service with an Audit Client	290.141
Serving as a Director or Officer of an Audit Client	290.144
Long Association of Senior Personnel (Including Partner Rotation) with an Audit Client	290.148
Provision of Non-assurance Services to Audit Clients	290.154
Management Responsibilities	290.159
Administrative Services	290.163
Preparing Accounting Records and Financial Statements	290.164
Valuation Services	290.171
Taxation Services	290.177
Internal Audit Services	290.190
IT Systems Services	290.196
Litigation Support Services	290.202
Legal Services	290.204
Recruiting Services	290.209
Corporate Finance Services	290.211
Fees	290.215
Fees—Relative Size	290.215
Fees—Overdue	290.218
Contingent Fees	290.219
Compensation and Evaluation Policies	290.223
Gifts and Hospitality	290.225
Actual or Threatened Litigation	290.226
Reports that Include a Restriction on Use and Distribution	290.500

Structure of Section

290.1 This section addresses the independence requirements for audit engagements and review engagements, which are assurance engagements in which a professional accountant in public practice expresses a conclusion on financial statements. Such engagements comprise audit and review engagements to report on a complete set of financial statements and a single financial statement. Independence requirements for assurance engagements that are not audit or review engagements are addressed in Section 291.

290.2 In certain circumstances involving audit engagements where the audit report includes a restriction on use and distribution and provided certain conditions are met, the independence requirements in this section may be modified as provided in paragraphs 290.500 to 290.514. The modifications are not permitted in the case of an audit of financial statements required by law or regulation.

290.3 In this section, the term(s):

- "Audit," "audit team," "audit engagement," "audit client" and "audit report" includes review, review team, review engagement, review client and review report; and
- "Firm" includes network firm, except where otherwise stated.

A Conceptual Framework Approach to Independence

290.4 In the case of audit engagements, it is in the public interest and, therefore, required by this Code of Ethics, that members of audit teams, firms and network firms shall be independent of audit clients.

290.5 The objective of this section is to assist firms and members of audit teams in applying the conceptual framework approach described below to achieving and maintaining independence.

290.6 Independence comprises:

Independence of Mind

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

Independence in Appearance

The avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that a firm's, or a member of the audit team's, integrity, objectivity or professional skepticism has been compromised.

290.7 The conceptual framework approach shall be applied by professional accountants to:

(a) Identify threats to independence;

(b) Evaluate the significance of the threats identified; and

(c) Apply safeguards, when necessary, to eliminate the threats or reduce them to an acceptable level.

When the professional accountant determines that appropriate safeguards are not available or cannot be applied to eliminate the threats or reduce them to an acceptable level, the professional accountant shall eliminate the circumstance or relationship creating the threats or decline or terminate the audit engagement.

A professional accountant shall use professional judgment in applying this conceptual framework.

290.8 Many different circumstances, or combinations of circumstances, may be relevant in assessing threats to independence. It is impossible to define every situation that creates threats to independence and to specify the appropriate action. Therefore, this Code establishes a conceptual framework that requires firms and members of audit teams to identify, evaluate, and address threats to independence. The conceptual framework approach assists professional accountants in practice in complying with the ethical requirements in this Code. It accommodates many variations in circumstances that create threats to independence and can deter a professional accountant from concluding that a situation is permitted if it is not specifically prohibited.

290.9 Paragraphs 290.100 and onwards describe how the conceptual framework approach to independence is to be applied. These paragraphs do not address all the circumstances and relationships that create or may create threats to independence.

290.10 In deciding whether to accept or continue an engagement, or whether a particular individual may be a member of the audit team, a firm shall identify and evaluate threats to independence. If the threats are not at an acceptable level, and the decision is whether to accept an engagement or include a particular individual on the audit team, the firm shall determine whether safeguards are available to eliminate the threats or reduce them to an acceptable level. If the decision is whether to continue an engagement, the firm shall determine whether any existing safeguards will continue to be effective to eliminate the threats or reduce them to an acceptable level or whether other safeguards will need to be applied or whether the engagement needs to be terminated. Whenever new information about a threat to independence comes to the attention of the firm during the engagement, the firm shall evaluate the significance of the threat in accordance with the conceptual framework approach.

290.11 Throughout this section, reference is made to the significance of threats to independence. In evaluating the significance of a threat, qualitative as well as quantitative factors shall be taken into account.

290.12 This section does not, in most cases, prescribe the specific responsibility of individuals within the firm for actions related to independence because responsibility may differ depending on the size, structure and organization of a firm. The firm is required by Hong Kong Standards on Quality Control to establish policies and procedures designed to provide it with reasonable assurance that independence is maintained when required by relevant ethical requirements. In addition, Hong Kong Standards on Auditing require the engagement partner to form a conclusion on compliance with the independence requirements that apply to the engagement.

Networks and Network Firms

290.13 If a firm is deemed to be a network firm, the firm shall be independent of the audit clients of the other firms within the network (unless otherwise stated in this Code). The independence requirements in this section that apply to a network firm apply to any entity, such as a consulting practice or professional law practice, that meets the definition of a network firm irrespective of whether the entity itself meets the definition of a firm.

290.14 To enhance their ability to provide professional services, firms frequently form larger structures with other firms and entities. Whether these larger structures create a network depends on the particular facts and circumstances and does not depend on whether the firms and entities are legally separate and distinct. For example, a larger structure may be aimed only at facilitating the referral of work, which in itself does not meet the criteria necessary to constitute a network. Alternatively, a larger structure might be such that it is aimed at co-operation and the firms share a common brand name, a common system of quality control, or significant professional resources and consequently is deemed to be a network.

290.15 The judgment as to whether the larger structure is a network shall be made in light of whether a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that the entities are associated in such a way that a network exists. This judgment shall be applied consistently throughout the network.

290.16 Where the larger structure is aimed at co-operation and it is clearly aimed at profit or cost sharing among the entities within the structure, it is deemed to be a network. However, the sharing of immaterial costs does not in itself create a network. In addition, if the sharing of costs is limited only to those costs related to the development of audit methodologies, manuals, or training courses, this would not in itself create a network. Further, an association between a firm and an otherwise unrelated entity to jointly provide a service or develop a product does not in itself create a network.

290.17 Where the larger structure is aimed at cooperation and the entities within the structure share common ownership, control or management, it is deemed to be a network. This could be achieved by contract or other means.

290.18 Where the larger structure is aimed at co-operation and the entities within the structure share common quality control policies and procedures, it is deemed to be a network. For this purpose, common quality control policies and procedures are those designed, implemented and monitored across the larger structure.

290.19 Where the larger structure is aimed at co-operation and the entities within the structure share a common business strategy, it is deemed to be a network. Sharing a common business strategy involves an agreement by the entities to achieve common strategic objectives. An entity is not deemed to be a network firm merely because it co-operates with another entity solely to respond jointly to a request for a proposal for the provision of a professional service.

290.20 Where the larger structure is aimed at co-operation and the entities within the structure share the use of a common brand name, it is deemed to be a network. A common brand name includes common initials or a common name. A firm is deemed to be using a common brand name if it includes, for example, the common brand name as part of, or along with, its firm name, when a partner of the firm signs an audit report.

290.21 Even though a firm does not belong to a network and does not use a common brand name as part of its firm name, it may give the appearance that it belongs to a network if it makes reference in its stationery or promotional materials to being a member of an association of firms. Accordingly, if care is not taken in how a firm describes such memberships, a perception may be created that the firm belongs to a network.

290.22 If a firm sells a component of its practice, the sales agreement sometimes provides that, for a limited period of time, the component may continue to use the name of the firm, or an element of the name, even though it is no longer connected to the firm. In such circumstances, while the two entities may be practicing under a common name, the facts are such that they do not belong to a larger structure aimed at co-operation and are, therefore, not network firms. Those entities shall determine how to disclose that they are not network firms when presenting themselves to outside parties.

290.23 Where the larger structure is aimed at co-operation and the entities within the structure share a significant part of professional resources, it is deemed to be a network. Professional resources include:

- Common systems that enable firms to exchange information such as client data, billing and time records;
- Partners and staff;
- Technical departments that consult on technical or industry specific issues, transactions or events for assurance engagements;

- Audit methodology or audit manuals; and
- Training courses and facilities.

290.24 The determination of whether the professional resources shared are significant, and therefore the firms are network firms, shall be made based on the relevant facts and circumstances. Where the shared resources are limited to common audit methodology or audit manuals, with no exchange of personnel or client or market information, it is unlikely that the shared resources would be significant. The same applies to a common training endeavor. Where, however, the shared resources involve the exchange of people or information, such as where staff are drawn from a shared pool, or a common technical department is created within the larger structure to provide participating firms with technical advice that the firms are required to follow, a reasonable and informed third party is more likely to conclude that the shared resources are significant.

Public Interest Entities

290.25 Section 290 contains additional provisions that reflect the extent of public interest in certain entities. For the purpose of this section, public interest entities are:

(a) All listed entities; and

(b) Any entity (a) defined by regulation or legislation as a public interest entity or (b) for which the audit is required by regulation or legislation to be conducted in compliance with the same independence requirements that apply to the audit of listed entities [1b]. Such regulation may be promulgated by any relevant regulator, including an audit regulator.

290.26 Firms are encouraged to determine whether to treat additional entities, or certain categories of entities, as public interest entities because they have a large number and wide range of stakeholders. Factors to be considered include:

- The nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders. Examples may include financial institutions, such as banks and insurance companies, and pension funds;
- Size; and
- Number of employees.

Related Entities

290.27 In the case of an audit client that is a listed entity, references to an audit client in this section include related entities of the client (unless otherwise stated). For all other audit clients, references to an audit client in this section include related entities over which the client has direct or indirect control. When the audit team knows or has reason to believe that a relationship or circumstance involving another related entity of the client is relevant to the evaluation of the firm's independence from the client, the audit team shall include that related entity when identifying and evaluating threats to independence and applying appropriate safeguards.

[1b] Currently under the legislation of Hong Kong, there is no definition of public interest entity or requirement for audit of an entity to be conducted with the same independence requirements applicable to the audit of listed entities. Hence, there is no entity falling within this part of the definition under the legislation of Hong Kong.

Those Charged with Governance

290.28 Even when not required by the Code, applicable auditing standards, law or regulation, regular communication is encouraged between the firm and those charged with governance of the audit client regarding relationships and other matters that might, in the firm's opinion, reasonably bear on independence. Such communication enables those charged with governance to:

(a) Consider the firm's judgments in identifying and evaluating threats to independence;

(b) Consider the appropriateness of safeguards applied to eliminate them or reduce them to an acceptable level; and

(c) Take appropriate action.

Such an approach can be particularly helpful with respect to intimidation and familiarity threats.

In complying with requirements in this section to communicate with those charged with governance, the firm shall determine, having regard to the nature and importance of the particular circumstances and matter to be communicated, the appropriate person(s) within the entity's governance structure with whom to communicate. If the firm communicates with a subgroup of those charged with governance, for example, an audit committee or an individual, the firm shall determine whether communication with all of those charged with governance is also necessary so that they are adequately informed.

Documentation

290.29 Documentation provides evidence of the professional accountant's judgments in forming conclusions regarding compliance with independence requirements. The absence of documentation is not a determinant of whether a firm considered a particular matter nor whether it is independent.

The professional accountant shall document conclusions regarding compliance with independence requirements, and the substance of any relevant discussions that support those conclusions. Accordingly:

(a) When safeguards are required to reduce a threat to an acceptable level, the professional accountant shall document the nature of the threat and the safeguards in place or applied that reduce the threat to an acceptable level; and

(b) When a threat required significant analysis to determine whether safeguards were necessary and the professional accountant concluded that they were not because the threat was already at an acceptable level, the professional accountant shall document the nature of the threat and the rationale for the conclusion.

Engagement Period

290.30 Independence from the audit client is required both during the engagement period and the period covered by the financial statements. The engagement period starts when the audit team begins to perform audit services. The engagement period ends when the audit report is issued. When the engagement is of a recurring nature, it ends at the later of the notification by either party that the professional relationship has terminated or the issuance of the final audit report.

290.31 When an entity becomes an audit client during or after the period covered by the financial statements on which the firm will express an opinion, the firm shall determine whether any threats to independence are created by:

(a) Financial or business relationships with the audit client during or after the period covered by the financial statements but before accepting the audit engagement; or

(b) Previous services provided to the audit client.

290.32 If a non-assurance service was provided to the audit client during or after the period covered by the financial statements but before the audit team begins to perform audit services and the service would not be permitted during the period of the audit engagement, the firm shall evaluate any threat to independence created by the service. If a threat is not at an acceptable level, the audit engagement shall only be accepted if safeguards are applied to eliminate any threats or reduce them to an acceptable level. Examples of such safeguards include:

- Not including personnel who provided the non-assurance service as members of the audit team;
- Having a professional accountant review the audit and non-assurance work as appropriate; or
- Engaging another firm to evaluate the results of the non-assurance service or having another firm re-perform the non-assurance service to the extent necessary to enable it to take responsibility for the service.

Mergers and Acquisitions

290.33 When, as a result of a merger or acquisition, an entity becomes a related entity of an audit client, the firm shall identify and evaluate previous and current interests and relationships with the related entity that, taking into account available safeguards, could affect its independence and therefore its ability to continue the audit engagement after the effective date of the merger or acquisition.

290.34 The firm shall take steps necessary to terminate, by the effective date of the merger or acquisition, any current interests or relationships that are not permitted under this Code. However, if such a current interest or relationship cannot reasonably be terminated by the effective date of the merger or acquisition, for example, because the related entity is unable by the effective date to effect an orderly transition to another service provider of a non-assurance service provided by the firm, the firm shall evaluate the threat that is created by such interest or relationship. The more significant the threat, the more likely the firm's objectivity will be compromised and it will be unable to continue as auditor. The significance of the threat will depend upon factors such as:

- The nature and significance of the interest or relationship;
- The nature and significance of the related entity relationship (for example, whether the related entity is a subsidiary or parent); and
- The length of time until the interest or relationship can reasonably be terminated.

The firm shall discuss with those charged with governance the reasons why the interest or relationship cannot reasonably be terminated by the effective date of the merger or acquisition and the evaluation of the significance of the threat.

290.35 If those charged with governance request the firm to continue as auditor, the firm shall do so only if:

(a) the interest or relationship will be terminated as soon as reasonably possible and in all cases within six months of the effective date of the merger or acquisition;

(b) any individual who has such an interest or relationship, including one that has arisen through performing a non-assurance service that would not be permitted under this section, will not be a member of the engagement team for the audit or the individual responsible for the engagement quality control review; and

(c) appropriate transitional measures will be applied, as necessary, and discussed with those charged with governance. Examples of transitional measures include:

- Having a professional accountant review the audit or non-assurance work as appropriate;

- Having a professional accountant, who is not a member of the firm expressing the opinion on the financial statements, perform a review that is equivalent to an engagement quality control review; or
- Engaging another firm to evaluate the results of the non-assurance service or having another firm re-perform the non-assurance service to the extent necessary to enable it to take responsibility for the service.

290.36 The firm may have completed a significant amount of work on the audit prior to the effective date of the merger or acquisition and may be able to complete the remaining audit procedures within a short period of time. In such circumstances, if those charged with governance request the firm to complete the audit while continuing with an interest or relationship identified in 290.33, the firm shall do so only if it:

(a) Has evaluated the significance of the threat created by such interest or relationship and discussed the evaluation with those charged with governance;

(b) Complies with the requirements of paragraph 290.35(b)–(c); and

(c) Ceases to be the auditor no later than the issuance of the audit report.

290.37 When addressing previous and current interests and relationships covered by paragraphs 290.33 to 290.36, the firm shall determine whether, even if all the requirements could be met, the interests and relationships create threats that would remain so significant that objectivity would be compromised and, if so, the firm shall cease to be the auditor.

290.38 The professional accountant shall document any interests or relationships covered by paragraphs 290.34 and 36 that will not be terminated by the effective date of the merger or acquisition and the reasons why they will not be terminated, the transitional measures applied, the results of the discussion with those charged with governance, and the rationale as to why the previous and current interests and relationships do not create threats that would remain so significant that objectivity would be compromised.

Breach of a Provision of this Section

290.39 A breach of a provision of this section may occur despite the firm having policies and procedures designed to provide it with reasonable assurance that independence is maintained. A consequence of a breach may be that termination of the audit engagement is necessary.

290.40 When the firm concludes that a breach has occurred, the firm shall terminate, suspend or eliminate the interest or relationship that caused the breach and address the consequences of the breach.

290.41 When a breach is identified, the firm shall consider whether there are any legal or regulatory requirements that apply with respect to the breach and, if so, shall comply with those requirements. The firm shall consider reporting the breach to the Institute, relevant regulator or oversight authority if such reporting is common practice or is expected in the particular jurisdiction.

290.42 When a breach is identified, the firm shall, in accordance with its policies and procedures, promptly communicate the breach to the engagement partner, those with responsibility for the policies and procedures relating to independence, other relevant personnel in the firm, and, where appropriate, the network, and those subject to the independence requirements who need to take appropriate action. The firm shall evaluate the significance of that breach and its impact on the firm's objectivity and ability to issue an audit report. The significance of the breach will depend on factors such as:

- The nature and duration of the breach;
- The number and nature of any previous breaches with respect to the current audit engagement;

- Whether a member of the audit team had knowledge of the interest or relationship that caused the breach;
- Whether the individual who caused the breach is a member of the audit team or another individual for whom there are independence requirements;
- If the breach relates to a member of the audit team, the role of that individual;
- If the breach was caused by the provision of a professional service, the impact of that service, if any, on the accounting records or the amounts recorded in the financial statements on which the firm will express an opinion; and
- The extent of the self-interest, advocacy, intimidation or other threats created by the breach.

290.43 Depending upon the significance of the breach, it may be necessary to terminate the audit engagement or it may be possible to take action that satisfactorily addresses the consequences of the breach. The firm shall determine whether such action can be taken and is appropriate in the circumstances. In making this determination, the firm shall exercise professional judgment and take into account whether a reasonable and informed third party, weighing the significance of the breach, the action to be taken and all the specific facts and circumstances available to the professional accountant at that time, would be likely to conclude that the firm's objectivity would be compromised and therefore the firm is unable to issue an audit report.

290.44 Examples of actions that the firm may consider include:

- Removing the relevant individual from the audit team;
- Conducting an additional review of the affected audit work or re-performing that work to the extent necessary, in either case using different personnel;
- Recommending that the audit client engage another firm to review or re-perform the affected audit work to the extent necessary; and
- Where the breach relates to a non-assurance service that affects the accounting records or an amount that is recorded in the financial statements, engaging another firm to evaluate the results of the non-assurance service or having another firm re-perform the non-assurance service to the extent necessary to enable it to take responsibility for the service.

290.45 If the firm determines that action cannot be taken to satisfactorily address the consequences of the breach, the firm shall inform those charged with governance as soon as possible and take the steps necessary to terminate the audit engagement in compliance with any applicable legal or regulatory requirements relevant to terminating the audit engagement. Where termination is not permitted by law or regulation, the firm shall comply with any reporting or disclosure requirements.

290.46 If the firm determines that action can be taken to satisfactorily address the consequences of the breach, the firm shall discuss the breach and the action it has taken or proposes to take with those charged with governance. The firm shall discuss the breach and the action as soon as possible, unless those charged with governance have specified an alternative timing for reporting less significant breaches. The matters to be discussed shall include:

- The significance of the breach, including its nature and duration;
- How the breach occurred and how it was identified;

- The action taken or proposed to be taken and the firm's rationale for why the action will satisfactorily address the consequences of the breach and enable it to issue an audit report;
- The conclusion that, in the firm's professional judgment, objectivity has not been compromised and the rationale for that conclusion; and
- Any steps that the firm has taken or proposes to take to reduce or avoid the risk of further breaches occurring.

290.47 The firm shall communicate in writing with those charged with governance all matters discussed in accordance with paragraph 290.46 and obtain the concurrence of those charged with governance that action can be, or has been, taken to satisfactorily address the consequences of the breach. The communication shall include a description of the firm's policies and procedures relevant to the breach designed to provide it with reasonable assurance that independence is maintained and any steps that the firm has taken, or proposes to take, to reduce or avoid the risk of further breaches occurring. If those charged with governance do not concur that the action satisfactorily addresses the consequences of the breach, the firm shall take the steps necessary to terminate the audit engagement, where permitted by law or regulation, in compliance with any applicable legal or regulatory requirements relevant to terminating the audit engagement. Where termination is not permitted by law or regulation, the firm shall comply with any reporting or disclosure requirements.

290.48 If the breach occurred prior to the issuance of the previous audit report, the firm shall comply with this section in evaluating the significance of the breach and its impact on the firm's objectivity and its ability to issue an audit report in the current period. The firm shall also consider the impact of the breach, if any, on the firm's objectivity in relation to any previously issued audit reports, and the possibility of withdrawing such audit reports, and discuss the matter with those charged with governance.

290.49 The firm shall document the breach, the action taken, key decisions made and all the matters discussed with those charged with governance and any discussions with the Institute, relevant regulator or oversight authority. When the firm continues with the audit engagement, the matters to be documented shall also include the conclusion that, in the firm's professional judgment, objectivity has not been compromised and the rationale for why the action taken satisfactorily addressed the consequences of the breach such that the firm could issue an audit report.

Paragraphs 290.50 to 290.99 are intentionally left blank.

Application of the Conceptual Framework Approach to Independence

290.100 Paragraphs 290.102 to 290.226 describe specific circumstances and relationships that create or may create threats to independence. The paragraphs describe the potential threats and the types of safeguards that may be appropriate to eliminate the threats or reduce them to an acceptable level and identify certain situations where no safeguards could reduce the threats to an acceptable level. The paragraphs do not describe all of the circumstances and relationships that create or may create a threat to independence. The firm and the members of the audit team shall evaluate the implications of similar, but different, circumstances and relationships and determine whether safeguards, including the safeguards in paragraphs 200.12 to 200.15, can be applied when necessary to eliminate the threats to independence or reduce them to an acceptable level.

290.101 Paragraphs 290.102 to 290.125 contain references to the materiality of a financial interest, loan, or guarantee, or the significance of a business relationship. For the purpose of determining whether such an interest is material to an individual, the combined net worth of the individual and the individual's immediate family members may be taken into account.

Financial Interests

290.102 Holding a financial interest in an audit client may create a self-interest threat. The existence and significance of any threat created depends on: (a) the role of the person holding the financial interest, (b) whether the financial interest is direct or indirect, and (c) the materiality of the financial interest.

290.103 Financial interests may be held through an intermediary (e.g. a collective investment vehicle, estate or trust). The determination of whether such financial interests are direct or indirect will depend upon whether the beneficial owner has control over the investment vehicle or the ability to influence its investment decisions. When control over the investment vehicle or the ability to influence investment decisions exists, this Code defines that financial interest to be a direct financial interest. Conversely, when the beneficial owner of the financial interest has no control over the investment vehicle or ability to influence its investment decisions, this Code defines that financial interest to be an indirect financial interest.

290.104 If a member of the audit team, a member of that individual's immediate family, or a firm has a direct financial interest or a material indirect financial interest in the audit client, the self-interest threat created would be so significant that no safeguards could reduce the threat to an acceptable level. Therefore, none of the following shall have a direct financial interest or a material indirect financial interest in the client: a member of the audit team; a member of that individual's immediate family; or the firm.

290.105 When a member of the audit team has a close family member who the audit team member knows has a direct financial interest or a material indirect financial interest in the audit client, a self-interest threat is created. The significance of the threat will depend on factors such as:

- The nature of the relationship between the member of the audit team and the close family member; and
- The materiality of the financial interest to the close family member.

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

- The close family member disposing, as soon as practicable, of all of the financial interest or disposing of a sufficient portion of an indirect financial interest so that the remaining interest is no longer material;
- Having a professional accountant review the work of the member of the audit team; or
- Removing the individual from the audit team.

290.106 If a member of the audit team, a member of that individual's immediate family, or a firm has a direct or material indirect financial interest in an entity that has a controlling interest in the audit client, and the client is material to the entity, the self-interest threat created would be so significant that no safeguards could reduce the threat to an acceptable level. Therefore, none of the following shall have such a financial interest: a member of the audit team; a member of that individual's immediate family; and the firm.

290.107 The holding by a firm's retirement benefit plan of a direct financial interest in an audit client creates a self-interest threat. The significance of the threat would be so significant that no safeguards 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.

290.108 If other partners in the office in which the engagement partner practices in connection with the audit engagement, or their immediate family members, hold a direct financial interest or a material indirect financial interest in that audit client, the self-interest threat created would be so significant that no safeguards could reduce the threat to an acceptable level. Therefore, neither such partners nor their immediate family members shall hold any such financial interests in such an audit client.

290.109 The office in which the engagement partner practices in connection with the audit engagement 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 audit team, professional judgment shall be used to determine in which office the partner practices in connection with that engagement.

290.110 If other partners and managerial employees who provide non-audit services to the audit client, except those whose involvement is minimal, or their immediate family members, hold a direct financial interest or a material indirect financial interest in the audit client, the self-interest threat created would be so significant that no safeguards could reduce the threat to an acceptable level. Accordingly, neither such personnel nor their immediate family members shall hold any such financial interests in such an audit client.

290.111 Despite paragraphs 290.108 and 290.110, the holding of a financial interest in an audit client by an immediate family member of (a) a partner located in the office in which the engagement partner practices in connection with the audit engagement, or (b) a partner or managerial employee who provides non-audit services to the audit client, is deemed not to compromise independence if the financial interest is received as a result of the immediate family member's employment rights (e.g., through pension or share option plans) and, when necessary, safeguards are applied to eliminate any threat to independence or reduce it to an acceptable level. However, when the immediate family member has or obtains the right to dispose of the financial interest or, in the case of a stock option, the right to exercise the option, the financial interest shall be disposed of or forfeited as soon as practicable.

290.112 A self-interest threat may be created if the firm or a member of the audit team, or a member of that individual's immediate family, has a financial interest in an entity and an audit client also has a financial interest in that entity. However, independence is deemed not to be compromised if these interests are immaterial and the audit client cannot exercise significant influence over the entity. If such interest is material to any party, and the audit client can exercise significant influence over the other entity, no safeguards could reduce the threat to an acceptable level. Accordingly, the firm shall not have such an interest and any individual with such an interest shall, before becoming a member of the audit team, either:

(a) Dispose of the interest; or

(b) Dispose of a sufficient amount of the interest so that the remaining interest is no longer material.

290.113 A self-interest, familiarity or intimidation threat may be created if a member of the audit team, or a member of that individual's immediate family, or the firm, has a financial interest in an entity when a director, officer or controlling owner of the audit client is also known to have a financial interest in that entity. The existence and significance of any threat will depend upon factors such as:

- The role of the professional on the audit team;
- Whether ownership of the entity is closely or widely held;
- Whether the interest gives the investor the ability to control or significantly influence the entity; and
- The materiality of the financial interest.

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

- Removing the member of the audit team with the financial interest from the audit team; or
- Having a professional accountant review the work of the member of the audit team.

290.114 The holding by a firm, or a member of the audit team, or a member of that individual's immediate family, of a direct financial interest or a material indirect financial interest in the audit client as a trustee creates a self-interest threat. Similarly, a self-interest threat is created when (a) a partner in the office in which the engagement partner practices in connection with the audit, (b) other partners and managerial employees who provide non-assurance services to the audit client, except those whose involvement is minimal, or (c) their immediate family members, hold a direct financial interest or a material indirect financial interest in the audit client as trustee. Such an interest shall not be held unless:

(a) Neither the trustee, nor an immediate family member of the trustee, nor the firm are beneficiaries of the trust;

(b) The interest in the audit client held by the trust is not material to the trust;

(c) The trust is not able to exercise significant influence over the audit client; and

(d) The trustee, an immediate family member of the trustee, or the firm cannot significantly influence any investment decision involving a financial interest in the audit client.

290.115 Members of the audit team shall determine whether a self-interest threat is created by any known financial interests in the audit client held by other individuals including:

(a) Partners and professional employees of the firm, other than those referred to above, or their immediate family members; and

(b) Individuals with a close personal relationship with a member of the audit team.

Whether these interests create a self-interest threat will depend on 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 audit team.

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

- Removing the member of the audit team with the personal relationship from the audit team;
- Excluding the member of the audit team from any significant decision-making concerning the audit engagement; or
- Having a professional accountant review the work of the member of the audit team.

290.116 If a firm or a partner or employee of the firm, or a member of that individual's immediate family, receives a direct financial interest or a material indirect financial interest in an audit client, for example, by way of an inheritance, gift or as a result of a merger and such interest would not be permitted to be held under this section, then:

(a) If the interest is received by the firm, the financial interest shall be disposed of immediately, or a sufficient amount of an indirect financial interest shall be disposed of so that the remaining interest is no longer material;

(b) If the interest is received by a member of the audit team, or a member of that individual's immediate family, the individual who received the financial interest shall immediately dispose of the financial interest, or dispose of a sufficient amount of an indirect financial interest so that the remaining interest is no longer material; or

(c) If the interest is received by an individual who is not a member of the audit team, or by an immediate family member of the individual, the financial interest shall be disposed of as soon as possible, or a sufficient amount of an indirect financial interest shall be disposed of so that the remaining interest is no longer material. Pending the disposal of the financial interest, a determination shall be made as to whether any safeguards are necessary.

Loans and Guarantees

290.117 A loan, or a guarantee of a loan, to a member of the audit team, or a member of that individual's immediate family, or the firm from an audit client that is a bank or a similar institution may create a threat to independence. If the loan or guarantee is not made under normal lending procedures, terms and conditions, a self-interest threat would be created that would be so significant that no safeguards could reduce the threat to an acceptable level. Accordingly, neither a member of the audit team, a member of that individual's immediate family, nor a firm shall accept such a loan or guarantee.

290.118 If a loan to a firm from an audit client that is a bank or similar institution is made under normal lending procedures, terms and conditions and it is material to the audit client or firm receiving the loan, it may be possible to apply safeguards to reduce the self-interest threat to an acceptable level. An example of such a safeguard is having the work reviewed by a professional accountant from a network firm that is neither involved with the audit nor received the loan.

290.119 A loan, or a guarantee of a loan, from an audit client that is a bank or a similar institution to a member of the audit team, or a member of that individual's immediate family, does not create a threat to independence if the loan or guarantee is made under normal lending procedures, terms and conditions. Examples of such loans include home mortgages, bank overdrafts, car loans and credit card balances.

290.120 If the firm or a member of the audit team, or a member of that individual's immediate family, accepts a loan from, or has a borrowing guaranteed by, an audit client that is not a bank or similar institution, the self-interest threat created would be so significant that no safeguards could reduce the threat to an acceptable level, unless the loan or guarantee is immaterial to both (a) the firm or the member of the audit team and the immediate family member, and (b) the client.

290.121 Similarly, if the firm or a member of the audit team, or a member of that individual's immediate family, makes or guarantees a loan to an audit client, the self-interest threat created would be so significant that no safeguards could reduce the threat to an acceptable level, unless the loan or guarantee is immaterial to both (a) the firm or the member of the audit team and the immediate family member, and (b) the client.

290.122 If a firm or a member of the audit team, or a member of that individual's immediate family, has deposits or a brokerage account with an audit client that is a bank, broker or similar institution, a threat to independence is not created if the deposit or account is held under normal commercial terms.

Business Relationships

290.123 A close business relationship between a firm, or a member of the audit team, or a member of that individual's immediate family, and the audit client or its management, arises from a commercial relationship or common financial interest and may create self-interest or intimidation threats. Examples of such relationships include:

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

Unless any financial interest is immaterial and the business relationship is insignificant to the firm and the client or its management, the threat created would be so significant that no safeguards could reduce the threat to an acceptable level. Therefore, unless the financial interest is immaterial and the business relationship is insignificant, the business relationship shall not be entered into, or it shall be reduced to an insignificant level or terminated.

In the case of a member of the audit team, unless any such financial interest is immaterial and the relationship is insignificant to that member, the individual shall be removed from the audit team.

If the business relationship is between an immediate family member of a member of the audit team and the audit client or its management, the significance of any threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level.

290.124 A business relationship involving the holding of an interest by the firm, or a member of the audit team, or a member of that individual's immediate family, in a closely-held entity when the audit client or a director or officer of the client, or any group thereof, also holds an interest in that entity does not create threats to independence if:

(a) The business relationship is insignificant to the firm, the member of the audit team and the immediate family member, and the client;

(b) The financial interest is immaterial to the investor or group of investors; and

(c) The financial interest does not give the investor, or group of investors, the ability to control the closely-held entity.

290.125 The purchase of goods and services from an audit client by the firm, or a member of the audit team, or a member of that individual's immediate family, does not generally create a threat to independence if the transaction is in the normal course of business and at arm's length. However, such transactions may be of such a nature or magnitude that they create a self-interest threat. The significance of any threat shall be evaluated and safeguards

applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:

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

Family and Personal Relationships

290.126 Family and personal relationships between a member of the audit team and a director or officer or certain employees (depending on their role) of the audit client may create self-interest, familiarity or intimidation threats. The existence and significance of any threats will depend on a number of factors, including the individual's responsibilities on the audit team, the role of the family member or other individual within the client and the closeness of the relationship.

290.127 When an immediate family member of a member of the audit team is:

(a) A director or officer of the audit client; or

(b) An employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion,

or was in such a position during any period covered by the engagement or the financial statements, the threats to independence can only be reduced to an acceptable level by removing the individual from the audit team. The closeness of the relationship is such that no other safeguards could reduce the threat to an acceptable level. Accordingly, no individual who has such a relationship shall be a member of the audit team.

290.128 Threats to independence are created when an immediate family member of a member of the audit team is an employee in a position to exert significant influence over the client's financial position, financial performance or cash flows. The significance of the threats will depend on factors such as:

- The position held by the immediate family member; and
- The role of the professional on the audit team.

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

- Removing the individual from the audit team; or
- Structuring the responsibilities of the audit team so that the professional does not deal with matters that are within the responsibility of the immediate family member.

290.129 Threats to independence are created when a close family member of a member of the audit team is:

(a) A director or officer of the audit client; or

(b) An employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion.

The significance of the threats will depend on factors such as:

- The nature of the relationship between the member of the audit team and the close family member;
- The position held by the close family member; and
- The role of the professional on the audit team.

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

- Removing the individual from the audit team; or
- Structuring the responsibilities of the audit team so that the professional does not deal with matters that are within the responsibility of the close family member.

290.130 Threats to independence are created when a member of the audit team has a close relationship with a person who is not an immediate or close family member, but who is a director or officer or an employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion. A member of the audit team who has such a relationship shall consult in accordance with firm policies and procedures. The significance of the threats will depend on factors such as:

- The nature of the relationship between the individual and the member of the audit team;
- The position the individual holds with the client; and
- The role of the professional on the audit team.

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

- Removing the professional from the audit team; or
- Structuring the responsibilities of the audit team so that the professional does not deal with matters that are within the responsibility of the individual with whom the professional has a close relationship.

290.131 Self-interest, familiarity or intimidation threats may be created by a personal or family relationship between (a) a partner or employee of the firm who is not a member of the audit team and (b) a director or officer of the audit client or an employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion. Partners and employees of the firm who are aware of such relationships shall consult in accordance with firm policies and procedures. The existence and significance of any threat will depend on factors such as:

- The nature of the relationship between the partner or employee of the firm and the director or officer or employee of the client;
- The interaction of the partner or employee of the firm with the audit team;
- The position of the partner or employee within the firm; and
- The position the individual holds with the client.

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

- Structuring the partner's or employee's responsibilities to reduce any potential influence over the audit engagement; or
- Having a professional accountant review the relevant audit work performed.

Employment with an Audit Client

290.132 Familiarity or intimidation threats may be created if a director or officer of the audit client, or an employee in a position to exert significant influence over the preparation of the client's

accounting records or the financial statements on which the firm will express an opinion, has been a member of the audit team or partner of the firm.

290.133 If a former member of the audit team or partner of the firm has joined the audit client in such a position and a significant connection remains between the firm and the individual, the threat would be so significant that no safeguards could reduce the threat to an acceptable level. Therefore, independence would be deemed to be compromised if a former member of the audit team or partner joins the audit client as a director or officer, or as an employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion, unless:

(a) The individual is not entitled to any benefits or payments from the firm, unless made in accordance with fixed pre-determined arrangements, and any amount owed to the individual is not material to the firm; and

(b) The individual does not continue to participate or appear to participate in the firm's business or professional activities.

290.134 If a former member of the audit team or partner of the firm has joined the audit client in such a position, and no significant connection remains between the firm and the individual, the existence and significance of any familiarity or intimidation threats will depend on factors such as:

- The position the individual has taken at the client;
- Any involvement the individual will have with the audit team;
- The length of time since the individual was a member of the audit team or partner of the firm; and
- The former position of the individual within the audit team or firm, for example, whether the individual was responsible for maintaining regular contact with the client's management or those charged with governance.

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

- Modifying the audit plan;
- Assigning individuals to the audit team who have sufficient experience in relation to the individual who has joined the client; or
- Having a professional accountant review the work of the former member of the audit team.

290.135 If a former partner of the firm has previously joined an entity in such a position and the entity subsequently becomes an audit client of the firm, the significance of any threat to independence shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level.

290.136 A self-interest threat is created when a member of the audit team participates in the audit engagement while knowing that the member of the audit team will, or may, join the client some time in the future. Firm policies and procedures shall require members of an audit team to notify the firm when entering employment negotiations with the client. On receiving such notification, the significance of the threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:

- Removing the individual from the audit team; or
- A review of any significant judgments made by that individual while on the team.

Audit Clients that are Public Interest Entities

290.137 Familiarity or intimidation threats are created when a key audit partner joins the audit client that is a public interest entity as:

(a) A director or officer of the entity; or

(b) An employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion.

Independence would be deemed to be compromised unless, subsequent to the partner ceasing to be a key audit partner, the public interest entity had issued audited financial statements covering a period of not less than twelve months and the partner was not a member of the audit team with respect to the audit of those financial statements.

290.138 An intimidation threat is created when the individual who was the firm's Senior or Managing Partner (Chief Executive or equivalent) joins an audit client that is a public interest entity as (a) an employee in a position to exert significant influence over the preparation of the entity's accounting records or its financial statements or (b) a director or officer of the entity. Independence would be deemed to be compromised unless twelve months have passed since the individual was the Senior or Managing Partner (Chief Executive or equivalent) of the firm.

290.139 Independence is deemed not to be compromised if, as a result of a business combination, a former key audit partner or the individual who was the firm's former Senior or Managing Partner is in a position as described in paragraphs 290.137 and 290.138, and:

(a) The position was not taken in contemplation of the business combination;

(b) Any benefits or payments due to the former partner from the firm have been settled in full, unless made in accordance with fixed pre-determined arrangements and any amount owed to the partner is not material to the firm;

(c) The former partner does not continue to participate or appear to participate in the firm's business or professional activities; and

(d) The position held by the former partner with the audit client is discussed with those charged with governance.

Temporary Staff Assignments

290.140 The lending of staff by a firm to an audit client may create a self-review threat. Such assistance may be given, but only for a short period of time and the firm's personnel shall not be involved in:

- Providing non-assurance services that would not be permitted under this section; or
- Assuming management responsibilities.

In all circumstances, the audit client shall be responsible for directing and supervising the activities of the loaned staff.

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

- Conducting an additional review of the work performed by the loaned staff;
- Not giving the loaned staff audit responsibility for any function or activity that the staff performed during the temporary staff assignment; or
- Not including the loaned staff as a member of the audit team.

Recent Service with an Audit Client

290.141 Self-interest, self-review or familiarity threats may be created if a member of the audit team has recently served as a director, officer, or employee of the audit client. This would be the case when, for example, a member of the audit team has to evaluate elements of the financial statements for which the member of the audit team had prepared the accounting records while with the client.

290.142 If, during the period covered by the audit report, a member of the audit team had served as a director or officer of the audit client, or was an employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion, the threat created would be so significant that no safeguards could reduce the threat to an acceptable level. Consequently, such individuals shall not be assigned to the audit team.

290.143 Self-interest, self-review or familiarity threats may be created if, before the period covered by the audit report, a member of the audit team had served as a director or officer of the audit client, or was an employee in a position to exert significant influence over the preparation of the client's accounting records or financial statements on which the firm will express an opinion. For example, such threats would be created if a decision made or work performed by the individual in the prior period, while employed by the client, is to be evaluated in the current period as part of the current audit engagement. The existence and significance of any threats will depend on factors such as:

- The position the individual held with the client;
- The length of time since the individual left the client; and
- The role of the professional on the audit team.

The significance of any threat shall be evaluated and safeguards applied when necessary to reduce the threat to an acceptable level. An example of such a safeguard is conducting a review of the work performed by the individual as a member of the audit team.

Serving as a Director or Officer of an Audit Client

290.144 If a partner or employee of the firm serves as a director or officer of an audit client, the self-review and self-interest threats created would be so significant that no safeguards could reduce the threats to an acceptable level. Accordingly, no partner or employee shall serve as a director or officer of an audit client.

290.145 The position of Company Secretary has different implications in different jurisdictions. Duties may range from administrative duties, such as personnel management and the maintenance of company records and registers, to duties as diverse as ensuring that the company complies with regulations or providing advice on corporate governance matters. Generally, this position is seen to imply a close association with the entity.

290.146 If a partner or employee of the firm or a network firm serves as Company Secretary for a financial statement audit client the self-review and advocacy threats created would generally be so significant that no safeguards could reduce the 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.

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

Long Association of Senior Personnel (Including Partner Rotation) with an Audit Client

General Provisions

290.148 Familiarity and self-interest threats are created by using the same senior personnel on an audit engagement over a long period of time. The significance of the threats will depend on factors such as:

- How long the individual has been a member of the audit team;
- The role of the individual on the audit team;
- The structure of the firm;
- The nature of the audit engagement;
- Whether the client's management team has changed; and
- Whether the nature or complexity of the client's accounting and reporting issues has changed.

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

- Rotating the senior personnel off the audit team;
- Having a professional accountant who was not a member of the audit team review the work of the senior personnel; or
- Regular independent internal or external quality reviews of the engagement.

Audit Clients that are Public Interest Entities

290.149 In respect of an audit of a public interest entity, an individual shall not be a key audit partner for more than seven years. After such time, the individual shall not be a member of the engagement team or be a key audit partner for the client for two years. During that period, the individual shall not participate in the audit of the entity, provide quality control for the engagement, consult with the engagement team or the client regarding technical or industry-specific issues, transactions or events or otherwise directly influence the outcome of the engagement.

290.150 Despite paragraph 290.149, key audit partners whose continuity is especially important to audit quality may, in rare cases due to unforeseen circumstances outside the firm's control, be permitted an additional year on the audit team as long as the threat to independence can be eliminated or reduced to an acceptable level by applying safeguards. For example, a key audit partner may remain on the audit team for up to one additional year in circumstances where, due to unforeseen events, a required rotation was not possible, as might be the case due to serious illness of the intended engagement partner.

290.151 The long association of other partners with an audit client that is a public interest entity creates familiarity and self-interest threats. The significance of the threats will depend on factors such as:

- How long any such partner has been associated with the audit client;
- The role, if any, of the individual on the audit team; and
- The nature, frequency and extent of the individual's interactions with the client's management or those charged with governance.

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

- Rotating the partner off the audit team or otherwise ending the partner's association with the audit client; or
- Regular independent internal or external quality reviews of the engagement.

290.152 When an audit client becomes a public interest entity, the length of time the individual has served the audit client as a key audit partner before the client becomes a public interest entity shall be taken into account in determining the timing of the rotation. If the individual has served the audit client as a key audit partner for five years or less when the client becomes a public interest entity, the number of years the individual may continue to serve the client in that capacity before rotating off the engagement is seven years less the number of years already served. If the individual has served the audit client as a key audit partner for six or more years when the client becomes a public interest entity, the partner may continue to serve in that capacity for a maximum of two additional years before rotating off the engagement.

290.153 When a firm has only a few people with the necessary knowledge and experience to serve as a key audit partner on the audit of a public interest entity, rotation of key audit partners may not be an available safeguard. If an independent regulator in the relevant jurisdiction has provided an exemption from partner rotation in such circumstances, an individual may remain a key audit partner for more than seven years, in accordance with such regulation, provided that the independent regulator has specified alternative safeguards which are applied, such as a regular independent external review.

Provision of Non-assurance Services to Audit Clients

290.154 Firms have traditionally provided to their audit clients a range of non-assurance services that are consistent with their skills and expertise. Providing non-assurance services may, however, create threats to the independence of the firm or members of the audit team. The threats created are most often self-review, self-interest and advocacy threats.

290.155 New developments in business, the evolution of financial markets and changes in information technology make it impossible to draw up an all-inclusive list of non-assurance services that might be provided to an audit client. When specific guidance on a particular non-assurance service is not included in this section, the conceptual framework shall be applied when evaluating the particular circumstances.

290.156 Before the firm accepts an engagement to provide a non-assurance service to an audit client, a determination shall be made as to whether providing such a service would create a threat to independence. In evaluating the significance of any threat created by a particular non-assurance service, consideration shall be given to any threat that the audit team has reason to believe is created by providing other related non-assurance services. If a threat is created that cannot be reduced to an acceptable level by the application of safeguards, the non-assurance service shall not be provided.

290.157 A firm may provide non-assurance services that would otherwise be restricted under this section to the following related entities of the audit client:

(a) An entity, which is not an audit client, that has direct or indirect control over the audit client;

(b) An entity, which is not an audit client, with a direct financial interest in the client if that entity has significant influence over the client and the interest in the client is material to such entity; or

(c) An entity, which is not an audit client, that is under common control with the audit client.

If it is reasonable to conclude that (a) the services do not create a self-review threat because the results of the services will not be subject to audit procedures and (b) any threats that are created by the provision of such services are eliminated or reduced to an acceptable level by the application of safeguards.

290.158 A non-assurance service provided to an audit client does not compromise the firm's independence when the client becomes a public interest entity if:

(a) The previous non-assurance service complies with the provisions of this section that relate to audit clients that are not public interest entities;

(b) Services that are not permitted under this section for audit clients that are public interest entities are terminated before or as soon as practicable after the client becomes a public interest entity; and

(c) The firm applies safeguards when necessary to eliminate or reduce to an acceptable level any threats to independence arising from the service.

Management Responsibilities

290.159 Management responsibilities involve controlling, leading and directing an entity, including making decisions regarding the acquisition, deployment and control of human, financial, technological, physical and intangible resources.

290.160 Determining whether an activity is a management responsibility depends on the circumstances and requires the exercise of judgment. Examples of activities that would be considered a management responsibility include:

- Setting policies and strategic direction.
- Hiring or dismissing employees.
- Directing and taking responsibility for the actions of employees in relation to the employees' work for the entity.
- Authorizing transactions.
- Controlling or managing of bank accounts or investments.
- Deciding which recommendations of the firm or other third parties to implement.
- Reporting to those charged with governance on behalf of management.
- Taking responsibility for the preparation and fair presentation of financial statements in accordance with the applicable financial reporting framework.
- Taking responsibility for designing, implementing, monitoring or maintaining internal controls.

290.161 A firm shall not assume a management responsibility for an audit client. The threats created would be so significant that no safeguards could reduce the threats to an acceptable level. For example, deciding which recommendations of the firm to implement will create self-review and self-interest threats. Further, assuming a management responsibility creates a familiarity threat because the firm becomes too closely aligned with the views and interests of management. Subject to compliance with paragraph 290.162, providing advice and recommendations to assist management in discharging its responsibilities is not assuming a management responsibility.

290.162 To avoid the risk of assuming a management responsibility when providing non-assurance services to an audit client, the firm shall be satisfied that client management makes all judgments and decisions that are the responsibility of management. This includes ensuring that the client's management:

- Designates an individual who possesses suitable skill, knowledge and experience to be responsible at all times for the client's decisions and to oversee the services. Such an individual, preferably within senior management, would understand the objectives, nature and results of the services and the respective client and firm responsibilities.

However, the individual is not required to possess the expertise to perform or re-perform the services;

- Provides oversight of the services and evaluates the adequacy of the results of the services performed for the client's purpose; and
- Accepts responsibility for the actions, if any, to be taken arising from the results of the services.

Administrative Services

290.163 Administrative services involve assisting clients with their routine or mechanical tasks within the normal course of operations. Such services require little to no professional judgment and are clerical in nature. Examples of administrative services include word processing services, preparing administrative or statutory forms for client approval, submitting such forms as instructed by the client, monitoring statutory filing dates, and advising an audit client of those dates. Providing such services does not generally create a threat to independence. However, the significance of any threat created shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level.

Preparing Accounting Records and Financial Statements

General Provisions

290.164 Management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework. These responsibilities include:

- Determining accounting policies and the accounting treatment within those policies.
- Preparing or changing 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).
- Originating or changing journal entries, or determining or approving the account classifications of transactions.

290.165 Providing an audit client with accounting and bookkeeping services, such as preparing accounting records or financial statements, creates a self-review threat when the firm subsequently audits the financial statements.

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

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

These activities are considered to be a normal part of the audit process and do not, generally, create threats to independence so long as the client is responsible for making decisions in the preparation of the accounting records and financial statements.

290.167 Similarly, the client may request technical assistance from the firm on matters such as resolving account reconciliation problems or analyzing and accumulating information for regulatory reporting. In addition, the client may request technical advice on accounting issues such as the conversion of existing financial statements from one financial reporting framework to another (for example, to comply with group accounting policies or to transition to a different financial reporting framework such as International Financial Reporting

Standards). Such services do not, generally, create threats to independence provided the firm does not assume a management responsibility for the client.

Audit Clients that are Not Public Interest Entities

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

- Preparing payroll calculations or reports based on client-originated data for approval and payment by the client.
- Recording recurring transactions for which amounts are easily determinable from source documents or originating data, such as a utility bill where the client has determined or approved the appropriate account classification.
- Recording a transaction for which the client has already determined the amount to be recorded, even though the transaction involves a significant degree of subjectivity.
- Calculating depreciation on fixed assets when the client determines the accounting policy and estimates of useful life and residual values.
- Posting client-approved entries to the trial balance.
- Preparing financial statements based on information in the client-approved trial balance and preparing the related notes based on client-approved records.

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

- Arranging for such services to be performed by an individual who is not a member of the audit team; or
- If such services are performed by a member of the audit team, using a partner or senior staff member with appropriate expertise who is not a member of the audit team to review the work performed.

Audit Clients that are Public Interest Entities

290.169 A firm shall not provide to an audit client that is a public interest entity accounting and bookkeeping services, including payroll services, or prepare financial statements on which the firm will express an opinion or financial information which forms the basis of the financial statements.

290.170 Despite paragraph 290.169, a firm may provide accounting and bookkeeping services, including payroll services and the preparation of financial statements or other financial information, of a routine or mechanical nature for divisions or related entities of an audit client that is a public interest entity if the personnel providing the services are not members of the audit team and:

(a) The divisions or related entities for which the service is provided are collectively immaterial to the financial statements on which the firm will express an opinion; or

(b) The services relate to matters that are collectively immaterial to the financial statements of the division or related entity.

Valuation Services

General Provisions

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

290.172 Performing valuation services for an audit client may create a self-review threat. The existence and significance of any threat will depend on factors such as:

- Whether the valuation will have a material effect on the financial statements.
- The extent of the client's involvement in determining and approving the valuation methodology and other significant matters of judgment.
- The availability of established methodologies and professional guidelines.
- For valuations involving standard or established methodologies, the degree of subjectivity inherent in the item.
- The reliability and extent of the underlying data.
- The degree of dependence on future events of a nature that could create significant volatility inherent in the amounts involved.
- The extent and clarity of the disclosures in the financial statements.

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

- Having a professional who was not involved in providing the valuation service review the audit or valuation work performed; or
- Making arrangements so that personnel providing such services do not participate in the audit engagement.

290.173 Certain valuations do not involve a significant degree of subjectivity. This is likely the case where the underlying assumptions are either established by law or regulation, or are widely accepted and when the techniques and methodologies to be used are based on generally accepted standards or prescribed by law or regulation. In such circumstances, the results of a valuation performed by two or more parties are not likely to be materially different.

290.174 If a firm is requested to perform a valuation to assist an audit client with its tax reporting obligations or for tax planning purposes and the results of the valuation will not have a direct effect on the financial statements, the provisions included in paragraph 290.186 apply.

Audit Clients that are Not Public Interest Entities

290.175 In the case of an audit client that is not a public interest entity, if the valuation service has a material effect on the financial statements on which the firm will express an opinion and the valuation involves a significant degree of subjectivity, no safeguards could reduce the self-review threat to an acceptable level. Accordingly a firm shall not provide such a valuation service to an audit client.

Audit Clients that are Public Interest Entities

290.176 A firm shall not provide valuation services to an audit client that is a public interest entity if the valuations would have a material effect, separately or in the aggregate, on the financial statements on which the firm will express an opinion.

Taxation Services

290.177 Taxation services comprise a broad range of services, including:

- Tax return preparation;
- Tax calculations for the purpose of preparing the accounting entries;
- Tax planning and other tax advisory services; and
- Assistance in the resolution of tax disputes.

While taxation services provided by a firm to an audit client are addressed separately under each of these broad headings; in practice, these activities are often interrelated.

290.178 Performing certain tax services creates self-review and advocacy threats. The existence and significance of any threats will depend on factors such as:

- The system by which the tax authorities assess and administer the tax in question and the role of the firm in that process;
- The complexity of the relevant tax regime and the degree of judgment necessary in applying it;
- The particular characteristics of the engagement; and
- The level of tax expertise of the client's employees.

Tax Return Preparation

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

Tax Calculations for the Purpose of Preparing Accounting Entries

Audit Clients that are Not Public Interest Entities

290.180 Preparing calculations of current and deferred tax liabilities (or assets) for an audit client for the purpose of preparing accounting entries that will be subsequently audited by the firm creates a self-review threat. The significance of the threat will depend on:

(a) The complexity of the relevant tax law and regulation and the degree of judgment necessary in applying them;

(b) The level of tax expertise of the client's personnel; and

(c) The materiality of the amounts to the financial statements.

Safeguards shall be applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:

- Using professionals who are not members of the audit team to perform the service;
- If the service is performed by a member of the audit team, using a partner or senior staff member with appropriate expertise who is not a member of the audit team to review the tax calculations; or

- Obtaining advice on the service from an external tax professional.

Audit Clients that are Public Interest Entities

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

Tax Planning and Other Tax Advisory Services

290.182 Tax planning or other tax advisory services comprise a broad range of services, such as advising the client how to structure its affairs in a tax efficient manner or advising on the application of a new tax law or regulation.

290.183 A self-review threat may be created where the advice will affect matters to be reflected in the financial statements. The existence and significance of any threat will depend on factors such as:

- The degree of subjectivity involved in determining the appropriate treatment for the tax advice in the financial statements;
- The extent to which the outcome of the tax advice will have a material effect on the financial statements;
- Whether the effectiveness of the tax advice depends on the accounting treatment or presentation in the financial statements and there is doubt as to the appropriateness of the accounting treatment or presentation under the relevant financial reporting framework;
- The level of tax expertise of the client's employees;
- The extent to which the advice is supported by tax law or regulation, other precedent or established practice; and
- Whether the tax treatment is supported by a private ruling or has otherwise been cleared by the tax authority before the preparation of the financial statements.

For example, providing tax planning and other tax advisory services where the advice is clearly supported by tax authority or other precedent, by established practice or has a basis in tax law that is likely to prevail does not generally create a threat to independence.

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

- Using professionals who are not members of the audit team to perform the service;
- Having a tax professional, who was not involved in providing the tax service, advise the audit team on the service and review the financial statement treatment;
- Obtaining advice on the service from an external tax professional; or
- Obtaining pre-clearance or advice from the tax authorities.

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

(a) The audit team has reasonable doubt as to the appropriateness of the related accounting treatment or presentation under the relevant financial reporting framework; and

(b) The outcome or consequences of the tax advice will have a material effect on the financial statements on which the firm will express an opinion;

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

290.186 In providing tax services to an audit client, a firm may be requested to perform a valuation to assist the client with its tax reporting obligations or for tax planning purposes. Where the result of the valuation will have a direct effect on the financial statements, the provisions included in paragraphs 290.171 to 290.176 relating to valuation services are applicable. Where the valuation is performed for tax purposes only and the result of the valuation will not have a direct effect on the financial statements (i.e. the financial statements are only affected through accounting entries related to tax), this would not generally create threats to independence if such effect on the financial statements is immaterial or if the valuation is subject to external review by a tax authority or similar regulatory authority. If the valuation is not subject to such an external review and the effect is material to the financial statements, the existence and significance of any threat created will depend upon factors such as:

- The extent to which the valuation methodology is supported by tax law or regulation, other precedent or established practice and the degree of subjectivity inherent in the valuation.
- The reliability and extent of the underlying data.

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

- Using professionals who are not members of the audit team to perform the service;
- Having a professional review the audit work or the result of the tax service; or
- Obtaining pre-clearance or advice from the tax authorities.

Assistance in the Resolution of Tax Disputes

290.187 An advocacy or self-review threat may be created when the firm represents an audit client in the resolution of a tax dispute once the tax authorities have notified the client that they have rejected the client's arguments on a particular issue and either the tax authority or the client is referring the matter for determination in a formal proceeding, for example before a tribunal or court. The existence and significance of any threat will depend on factors such as:

- Whether the firm has provided the advice which is the subject of the tax dispute;
- The extent to which the outcome of the dispute will have a material effect on the financial statements on which the firm will express an opinion;
- The extent to which the matter is supported by tax law or regulation, other precedent, or established practice;
- Whether the proceedings are conducted in public; and
- The role management plays in the resolution of the dispute.

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

- Using professionals who are not members of the audit team to perform the service;
- Having a tax professional, who was not involved in providing the tax service, advise the audit team on the services and review the financial statement treatment; or
- Obtaining advice on the service from an external tax professional.

290.188 Where the taxation services involve acting as an advocate for an audit client before a public tribunal or court in the resolution of a tax matter and the amounts involved are material to the financial statements on which the firm will express an opinion, the advocacy threat created would be so significant that no safeguards could eliminate or reduce the threat to an acceptable level. Therefore, the firm shall not perform this type of service for an audit

client. What constitutes a "public tribunal or court" shall be determined according to how tax proceedings are heard in the particular jurisdiction.

290.189 The firm is not, however, precluded from having a continuing advisory role (for example, responding to specific requests for information, providing factual accounts or testimony about the work performed or assisting the client in analyzing the tax issues) for the audit client in relation to the matter that is being heard before a public tribunal or court.

Internal Audit Services

General Provisions

290.190 The scope and objectives of internal audit activities vary widely and depend on the size and structure of the entity and the requirements of management and those charged with governance. Internal audit activities may include:

- Monitoring of internal control – reviewing controls, monitoring their operation and recommending improvements thereto;
- Examination of financial and operating information – reviewing the means used to identify, measure, classify and report financial and operating information, and specific inquiry into individual items including detailed testing of transactions, balances and procedures;
- Review of the economy, efficiency and effectiveness of operating activities including non-financial activities of an entity; and
- Review of compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.

290.191 Internal audit services involve assisting the audit client in the performance of its internal audit activities. The provision of internal audit services to an audit client creates a self-review threat to independence if the firm uses the internal audit work in the course of a subsequent external audit. Performing a significant part of the client's internal audit activities increases the possibility that firm personnel providing internal audit services will assume a management responsibility. If the firm's personnel assume a management responsibility when providing internal audit services to an audit client, the threat created would be so significant that no safeguards could reduce the threat to an acceptable level. Accordingly, a firm's personnel shall not assume a management responsibility when providing internal audit services to an audit client.

290.192 Examples of internal audit services that involve assuming management responsibilities include:

(a) Setting internal audit policies or the strategic direction of internal audit activities;

(b) Directing and taking responsibility for the actions of the entity's internal audit employees;

(c) Deciding which recommendations resulting from internal audit activities shall be implemented;

(d) Reporting the results of the internal audit activities to those charged with governance on behalf of management;

(e) Performing procedures that form part of the internal control, such as reviewing and approving changes to employee data access privileges;

(f) Taking responsibility for designing, implementing and maintaining internal control; and

(g) Performing outsourced internal audit services, comprising all or a substantial portion of the internal audit function, where the firm is responsible for determining the scope of the internal audit work and may have responsibility for one or more of the matters noted in (a)–(f).

290.193 To avoid assuming a management responsibility, the firm shall only provide internal audit services to an audit client if it is satisfied that:

(a) The client designates an appropriate and competent resource, preferably within senior management, to be responsible at all times for internal audit activities and to acknowledge responsibility for designing, implementing, and maintaining internal control;

(b) The client's management or those charged with governance reviews, assesses and approves the scope, risk and frequency of the internal audit services;

(c) The client's management evaluates the adequacy of the internal audit services and the findings resulting from their performance;

(d) The client's management evaluates and determines which recommendations resulting from internal audit services to implement and manages the implementation process; and

(e) The client's management reports to those charged with governance the significant findings and recommendations resulting from the internal audit services.

290.194 When a firm uses the work of an internal audit function, Hong Kong Standards on Auditing require the performance of procedures to evaluate the adequacy of that work. When a firm accepts an engagement to provide internal audit services to an audit client, and the results of those services will be used in conducting the external audit, a self-review threat is created because of the possibility that the audit team will use the results of the internal audit service without appropriately evaluating those results or exercising the same level of professional skepticism as would be exercised when the internal audit work is performed by individuals who are not members of the firm. The significance of the threat will depend on factors such as:

- The materiality of the related financial statement amounts;
- The risk of misstatement of the assertions related to those financial statement amounts; and
- The degree of reliance that will be placed on the internal audit service.

The significance of the threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. An example of such a safeguard is using professionals who are not members of the audit team to perform the internal audit service.

Audit Clients that are Public Interest Entities

290.195 In the case of an audit client that is a public interest entity, a firm shall not provide internal audit services that relate to:

(a) A significant part of the internal controls over financial reporting;

(b) Financial accounting systems that generate information that is, separately or in the aggregate, significant to the client's accounting records or financial statements on which the firm will express an opinion; or

(c) Amounts or disclosures that are, separately or in the aggregate, material to the financial statements on which the firm will express an opinion.

IT Systems Services

General Provisions

290.196 Services related to information technology ("IT") systems include the design or implementation of hardware or software systems. The systems may aggregate source data, form part of the internal control over financial reporting or generate information that affects the accounting records or financial statements, or the systems may be unrelated to the

audit client's accounting records, the internal control over financial reporting or financial statements. Providing systems services may create a self-review threat depending on the nature of the services and the IT systems.

290.197 The following IT systems services are deemed not to create a threat to independence as long as the firm's personnel do not assume a management responsibility:

(a) Design or implementation of IT systems that are unrelated to internal control over financial reporting;

(b) Design or implementation of IT systems that do not generate information forming a significant part of the accounting records or financial statements;

(c) Implementation of "off-the-shelf" accounting or financial information reporting software that was not developed by the firm if the customization required to meet the client's needs is not significant; and

(d) Evaluating and making recommendations with respect to a system designed, implemented or operated by another service provider or the client.

Audit Clients that are Not Public Interest Entities

290.198 Providing services to an audit client that is not a public interest entity involving the design or implementation of IT systems that (a) form a significant part of the internal control over financial reporting or (b) generate information that is significant to the client's accounting records or financial statements on which the firm will express an opinion creates a self-review threat.

290.199 The self-review threat is too significant to permit such services unless appropriate safeguards are put in place ensuring that:

(a) The client acknowledges its responsibility for establishing and monitoring a system of internal controls;

(b) The client assigns the responsibility to make all management decisions with respect to the design and implementation of the hardware or software system to a competent employee, preferably within senior management;

(c) The client makes all management decisions with respect to the design and implementation process;

(d) The client evaluates the adequacy and results of the design and implementation of the system; and

(e) The client is responsible for operating the system (hardware or software) and for the data it uses or generates.

290.200 Depending on the degree of reliance that will be placed on the particular IT systems as part of the audit, a determination shall be made as to whether to provide such non-assurance services only with personnel who are not members of the audit team and who have different reporting lines within the firm. The significance of any remaining threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. An example of such a safeguard is having a professional accountant review the audit or non-assurance work.

Audit Clients that are Public Interest Entities

290.201 In the case of an audit client that is a public interest entity, a firm shall not provide services involving the design or implementation of IT systems that (a) form a significant part of the internal control over financial reporting or (b) generate information that is significant to the client's accounting records or financial statements on which the firm will express an opinion.

Litigation Support Services

290.202 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. These services may create a self-review or advocacy threat.

290.203 If the firm provides a litigation support service to an audit client and the service involves estimating damages or other amounts that affect the financial statements on which the firm will express an opinion, the valuation service provisions included in paragraphs 290.171 to 290.176 shall be followed. In the case of other litigation support services, the significance of any threat created shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level.

Legal Services

290.204 For the purpose of this section, legal services are defined as any services for which the person providing the services must either be admitted to practice law before the courts of the jurisdiction in which such services are to be provided or have the required legal training to practice law. Such legal services may include, depending on the jurisdiction, a wide and diversified range of areas including both corporate and commercial services to clients, such as contract support, litigation, mergers and acquisition legal advice and support and assistance to clients' internal legal departments. Providing legal services to an entity that is an audit client may create both self-review and advocacy threats.

290.205 Legal services that support an audit client in executing a transaction (e.g., contract support, legal advice, legal due diligence and restructuring) may create self-review threats. The existence and significance of any threat will depend on factors such as:

- The nature of the service;
- Whether the service is provided by a member of the audit team; and
- The materiality of any matter in relation to the client's financial statements.

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

- Using professionals who are not members of the audit team to perform the service; or
- Having a professional who was not involved in providing the legal services provide advice to the audit team on the service and review any financial statement treatment.

290.206 Acting in an advocacy role for an audit client in resolving a dispute or litigation when the amounts involved are material to the financial statements on which the firm will express an opinion would create advocacy and self-review threats so significant that no safeguards could reduce the threat to an acceptable level. Therefore, the firm shall not perform this type of service for an audit client.

290.207 When a firm is asked to act in an advocacy role for an audit client in resolving a dispute or litigation when the amounts involved are not material to the financial statements on which the firm will express an opinion, the firm shall evaluate the significance of any advocacy and self-review threats created and apply safeguards when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:

- Using professionals who are not members of the audit team to perform the service; or
- Having a professional who was not involved in providing the legal services advise the audit team on the service and review any financial statement treatment.

290.208 The appointment of a partner or an employee of the firm as General Counsel for legal affairs of an audit client would create self-review and advocacy threats that are so significant that 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 shall accept such an appointment for an audit client.

Recruiting Services

General Provisions

290.209 Providing recruiting services to an audit client may create self-interest, familiarity or intimidation threats. The existence and significance of any threat will depend on factors such as:

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

The significance of any threat created shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. In all cases, the firm shall not assume management responsibilities, including acting as a negotiator on the client's behalf, and the hiring decision shall be left to the client.

The firm may generally provide such services as reviewing the professional qualifications of a number of applicants and providing advice on their suitability for the post. In addition, the firm may interview candidates and advise on a candidate's competence for financial accounting, administrative or control positions.

Audit Clients that are Public Interest Entities

290.210 A firm shall not provide the following recruiting services to an audit client that is a public interest entity with respect to a director or officer of the entity or senior management in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion:

- Searching for or seeking out candidates for such positions; and
- Undertaking reference checks of prospective candidates for such positions.

Corporate Finance Services

290.211 Providing corporate finance services such as:

- Assisting an audit client in developing corporate strategies;
- Identifying possible targets for the audit client to acquire;
- Advising on disposal transactions;
- Assisting finance raising transactions; and
- Providing structuring advice,

may create advocacy and self-review threats. The significance of any threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:

- Using professionals who are not members of the audit team to provide the services; or
- Having a professional who was not involved in providing the corporate finance service advise the audit team on the service and review the accounting treatment and any financial statement treatment.

290.212 Providing a corporate finance service, for example advice on the structuring of a corporate finance transaction or on financing arrangements that will directly affect amounts that will be reported in the financial statements on which the firm will provide an opinion may create a self-review threat. The existence and significance of any threat will depend on factors such as:

- The degree of subjectivity involved in determining the appropriate treatment for the outcome or consequences of the corporate finance advice in the financial statements;
- The extent to which the outcome of the corporate finance advice will directly affect amounts recorded in the financial statements and the extent to which the amounts are material to the financial statements; and
- Whether the effectiveness of the corporate finance advice depends on a particular accounting treatment or presentation in the financial statements and there is doubt as to the appropriateness of the related accounting treatment or presentation under the relevant financial reporting framework.

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

- Using professionals who are not members of the audit team to perform the service; or
- Having a professional who was not involved in providing the corporate finance service to the client advise the audit team on the service and review the accounting treatment and any financial statement treatment.

290.213 Where the effectiveness of corporate finance advice depends on a particular accounting treatment or presentation in the financial statements and:

(a) The audit team has reasonable doubt as to the appropriateness of the related accounting treatment or presentation under the relevant financial reporting framework; and

(b) The outcome or consequences of the corporate finance advice will have a material effect on the financial statements on which the firm will express an opinion;

The self-review threat would be so significant that no safeguards could reduce the threat to an acceptable level, in which case the corporate finance advice shall not be provided.

290.214 Providing corporate finance services involving promoting, dealing in, or underwriting an audit client's shares would create an advocacy or self-review threat that is so significant that no safeguards could reduce the threat to an acceptable level. Accordingly, a firm shall not provide such services to an audit client.

Fees

Fees—Relative Size

290.215 When the total fees from an audit client represent a large proportion of the total fees of the firm expressing the audit opinion, the dependence on that client and concern about losing the client creates a self-interest or intimidation threat. The significance of the threat will depend on factors such as:

- The operating structure of the firm;
- Whether the firm is well established or new; and
- The significance of the client qualitatively and/or quantitatively to the firm.

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

- Reducing the dependency on the client;
- External quality control reviews; or
- Consulting a third party, such as a professional regulatory body or a professional accountant, on key audit judgments.

290.216 A self-interest or intimidation threat is also created when the fees generated from an audit client represent a large proportion of the revenue from an individual partner's clients or a large proportion of the revenue of an individual office of the firm. The significance of the threat will depend upon factors such as:

- The significance of the client qualitatively and/or quantitatively to the partner or office; and
- The extent to which the remuneration of the partner, or the partners in the office, is dependent upon the fees generated from the client.

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

- Reducing the dependency on the audit client;
- Having a professional accountant review the work or otherwise advise as necessary; or
- Regular independent internal or external quality reviews of the engagement.

Audit Clients that are Public Interest Entities

290.217 Where an audit client is a public interest entity and, for two consecutive years, the total fees from the client and its related entities (subject to the considerations in paragraph 290.27) represent more than 15% of the total fees received by the firm expressing the opinion on the financial statements of the client, the firm shall disclose to those charged with governance of the audit client the fact that the total of such fees represents more than 15% of the total fees received by the firm, and discuss which of the safeguards below it will apply to reduce the threat to an acceptable level, and apply the selected safeguard:

- Prior to the issuance of the audit opinion on the second year's financial statements, a professional accountant, who is not a member of the firm expressing the opinion on the financial statements, performs an engagement quality control review of that engagement or a professional regulatory body performs a review of that engagement that is equivalent to an engagement quality control review ("a pre-issuance review"); or
- After the audit opinion on the second year's financial statements has been issued, and before the issuance of the audit opinion on the third year's financial statements, a professional accountant, who is not a member of the firm expressing the opinion on the financial statements, or a professional regulatory body performs a review of the second year's audit that is equivalent to an engagement quality control review ("a post-issuance review").

When the total fees significantly exceed 15%, the firm shall determine whether the significance of the threat is such that a post-issuance review would not reduce the threat to an acceptable level and, therefore, a pre-issuance review is required. In such circumstances a pre-issuance review shall be performed.

Thereafter, when the fees continue to exceed 15% each year, the disclosure to and discussion with those charged with governance shall occur and one of the above safeguards shall be applied. If the fees significantly exceed 15%, the firm shall determine whether the significance of the threat is such that a post-issuance review would not reduce the threat to an acceptable level and, therefore, a pre-issuance review is required. In such circumstances a pre-issuance review shall be performed.

Fees—Overdue

290.218 A self-interest threat may be created if fees due from an audit client remain unpaid for a long time, especially if a significant part is not paid before the issue of the audit report for the following year. Generally the firm is expected to require payment of such fees before

such audit report is issued. If fees remain unpaid after the report has been issued, the existence and significance of any threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. An example of such a safeguard is having an additional professional accountant who did not take part in the audit engagement provide advice or review the work performed. The firm shall determine 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 or continue the audit engagement.

Contingent Fees

290.219 Contingent fees are fees calculated on a predetermined basis relating to the outcome of a transaction or the result of the services performed by the firm. For the purposes of this section, a fee is not regarded as being contingent if established by a court or other public authority.

290.220 A contingent fee charged directly or indirectly, for example through an intermediary, by a firm in respect of an audit engagement creates a self-interest threat that is so significant that no safeguards could reduce the threat to an acceptable level. Accordingly, a firm shall not enter into any such fee arrangement.

290.221 A contingent fee charged directly or indirectly, for example through an intermediary, by a firm in respect of a non-assurance service provided to an audit client may also create a self-interest threat. The threat created would be so significant that no safeguards could reduce the threat to an acceptable level if:

(a) The fee is charged by the firm expressing the opinion on the financial statements and the fee is material or expected to be material to that firm;

(b) The fee is charged by a network firm that participates in a significant part of the audit and the fee is material or expected to be material to that firm; or

(c) The outcome of the non-assurance service, and therefore the amount of the fee, is dependent on a future or contemporary judgment related to the audit of a material amount in the financial statements.

Accordingly, such arrangements shall not be accepted.

290.222 For other contingent fee arrangements charged by a firm for a non-assurance service to an audit client, the existence and significance of any threats will depend on factors such as:

- The range of possible fee amounts;
- Whether an appropriate authority determines the outcome of the matter upon which the contingent fee will be determined;
- The nature of the service; and
- The effect of the event or transaction on the financial statements.

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

- Having a professional accountant review the relevant audit work or otherwise advise as necessary; or
- Using professionals who are not members of the audit team to perform the non-assurance service.

Compensation and Evaluation Policies

290.223 A self-interest threat is created when a member of the audit team is evaluated on or compensated for selling non-assurance services to that audit client. The significance of the threat will depend on:

- The proportion of the individual's compensation or performance evaluation that is based on the sale of such services;
- The role of the individual on the audit team; and
- Whether promotion decisions are influenced by the sale of such services.

The significance of the threat shall be evaluated and, if the threat is not at an acceptable level, the firm shall either revise the compensation plan or evaluation process for that individual or apply safeguards to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:

- Removing such members from the audit team; or
- Having a professional accountant review the work of the member of the audit team.

290.224 A key audit partner shall not be evaluated on or compensated based on that partner's success in selling non-assurance services to the partner's audit client. This is not intended to prohibit normal profit-sharing arrangements between partners of a firm.

Gifts and Hospitality

290.225 Accepting gifts or hospitality from an audit client may create self-interest and familiarity threats. If a firm or a member of the audit team accepts gifts or hospitality, unless the value is trivial and inconsequential, the threats created would be so significant that no safeguards could reduce the threats to an acceptable level. Consequently, a firm or a member of the audit team shall not accept such gifts or hospitality.

Actual or Threatened Litigation

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

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

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

- If the litigation involves a member of the audit team, removing that individual from the audit team; or
- Having a professional review the work performed.

If such safeguards do not reduce the threats to an acceptable level, the only appropriate action is to withdraw from, or decline, the audit engagement.

Paragraphs 290.227 to 290.499 are intentionally left blank.

Reports that Include a Restriction on Use and Distribution

Introduction

290.500 The independence requirements in Section 290 apply to all audit engagements. However, in certain circumstances involving audit engagements where the report includes a restriction on use and distribution, and provided the conditions described in 290.501 to 290.502 are met, the independence requirements in this section may be modified as provided in paragraphs 290.505 to 290.514. These paragraphs are only applicable to an audit

engagement on special purpose financial statements (a) that is intended to provide a conclusion in positive or negative form that the financial statements are prepared in all material respects, in accordance with the applicable financial reporting framework, including, in the case of a fair presentation framework, that the financial statements give a true and fair view or are presented fairly, in all material respects, in accordance with the applicable financial reporting framework, and (b) where the audit report includes a restriction on use and distribution. The modifications are not permitted in the case of an audit of financial statements required by law or regulation.

290.501 The modifications to the requirements of Section 290 are permitted if the intended users of the report (a) are knowledgeable as to the purpose and limitations of the report, and (b) explicitly agree to the application of the modified independence requirements. Knowledge as to the purpose and limitations of the report may be obtained by the intended users through their participation, either directly or indirectly through their representative who has the authority to act for the intended users, in establishing the nature and scope of the engagement. Such participation enhances the ability of the firm to communicate with intended users about independence matters, including the circumstances that are relevant to the evaluation of the threats to independence and the applicable safeguards necessary to eliminate the threats or reduce them to an acceptable level, and to obtain their agreement to the modified independence requirements that are to be applied.

290.502 The firm shall communicate (for example, in an engagement letter) with the intended users regarding the independence requirements that are to be applied with respect to the provision of the audit engagement. Where the intended users are a class of users (for example, lenders in a syndicated loan arrangement) who are not specifically identifiable by name at the time the engagement terms are established, such users shall subsequently be made aware of the independence requirements agreed to by the representative (for example, by the representative making the firm's engagement letter available to all users).

290.503 If the firm also issues an audit report that does not include a restriction on use and distribution for the same client, the provisions of paragraphs 290.500 to 290.514 do not change the requirement to apply the provisions of paragraphs 290.1 to 290.226 to that audit engagement.

290.504 The modifications to the requirements of Section 290 that are permitted in the circumstances set out above are described in paragraphs 290.505 to 290.514. Compliance in all other respects with the provisions of Section 290 is required.

Public Interest Entities

290.505 When the conditions set out in paragraphs 290.500 to 290.502 are met, it is not necessary to apply the additional requirements in paragraphs 290.100 to 290.226 that apply to audit engagements for public interest entities.

Related Entities

290.506 When the conditions set out in paragraphs 290.500 to 290.502 are met, references to audit client do not include its related entities. However, when the audit team knows or has reason to believe that a relationship or circumstance involving a related entity of the client is relevant to the evaluation of the firm's independence of the client, the audit team shall include that related entity when identifying and evaluating threats to independence and applying appropriate safeguards.

Networks and Network Firms

290.507 When the conditions set out in paragraphs 290.500 to 290.502 are met, reference to the firm does not include network firms. However, when the firm knows or has reason to believe that threats are created by any interests and relationships of a network firm, they shall be included in the evaluation of threats to independence.

Financial Interests, Loans and Guarantees, Close Business Relationships and Family and Personal Relationships

290.508 When the conditions set out in paragraphs 290.500 to 290.502 are met, the relevant provisions set out in paragraphs 290.102 to 290.143 apply only to the members of the engagement team, their immediate family members and close family members.

290.509 In addition, a determination shall be made as to whether threats to independence are created by interests and relationships, as described in paragraphs 290.102 to 290.143, between the audit client and the following members of the audit team:

(a) Those who provide consultation regarding technical or industry specific issues, transactions or events; and

(b) Those who provide quality control for the engagement, including those who perform the engagement quality control review.

An evaluation shall be made of the significance of any threats that the engagement team has reason to believe are created by interests and relationships between the audit client and others within the firm who can directly influence the outcome of the audit engagement, including those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the audit engagement partner in connection with the performance of the audit engagement (including those at all successively senior levels above the engagement partner through to the individual who is the firm's Senior or Managing Partner (Chief Executive or equivalent)).

290.510 An evaluation shall also be made of the significance of any threats that the engagement team has reason to believe are created by financial interests in the audit client held by individuals, as described in paragraphs 290.108 to 290.111 and paragraphs 290.113 to 290.115.

290.511 Where a threat to independence is not at an acceptable level, safeguards shall be applied to eliminate the threat or reduce it to an acceptable level.

290.512 In applying the provisions set out in paragraphs 290.106 and 290.115 to interests of the firm, if the firm has a material financial interest, whether direct or indirect, in the audit client, the self-interest threat created would be so significant that no safeguards could reduce the threat to an acceptable level. Accordingly, the firm shall not have such a financial interest.

Employment with an Audit Client

290.513 An evaluation shall be made of the significance of any threats from any employment relationships as described in paragraphs 290.132 to 290.136. Where a threat exists that is not at an acceptable level, safeguards shall be applied to eliminate the threat or reduce it to an acceptable level. Examples of safeguards that might be appropriate include those set out in paragraph 290.134.

Provision of Non-Assurance Services

290.514 If the firm conducts an engagement to issue a restricted use and distribution report for an audit client and provides a non-assurance service to the audit client, the provisions of paragraphs 290.154 to 290.226 shall be complied with, subject to paragraphs 290.504 to 290.507.

SECTION 291
INDEPENDENCE—OTHER ASSURANCE ENGAGEMENTS
CONTENTS

	Paragraph
Structure of Section	291.1
A Conceptual Framework Approach to Independence	291.4
Assurance Engagements	291.12
Assertion-Based Assurance Engagements	291.17
Direct Reporting Assurance Engagements	291.20
Reports that Include a Restriction on Use and Distribution	291.21
Multiple Responsible Parties	291.28
Documentation	291.29
Engagement Period	291.30
Breach of a Provision of this Section	291.33
Application of the Conceptual Framework Approach to Independence	291.100
Financial Interests	291.104
Loans and Guarantees	291.112
Business Relationships	291.118
Family and Personal Relationships	291.120
Employment with Assurance Clients	291.126
Recent Service with an Assurance Client	291.130
Serving as a Director or Officer of an Assurance Client	291.133
Long Association of Senior Personnel with an Assurance Client	291.137
Provision of Non-assurance Services to an Assurance Client	291.138
Management Responsibilities	291.141
Other Considerations	291.145
Fees	291.148
Fees—Relative Size	291.148
Fees—Overdue	291.150
Contingent Fees	291.151
Gifts and Hospitality	291.155
Actual or Threatened Litigation	291.156

Structure of Section

291.1 This section addresses independence requirements for assurance engagements that are not audit or review engagements. Independence requirements for audit and review engagements are addressed in Section 290. If the assurance client is also an audit or review client, the requirements in Section 290 also apply to the firm, network firms and members of the audit or review team. In certain circumstances involving assurance engagements where the assurance report includes a restriction on use and distribution and provided certain conditions are met, the independence requirements in this section may be modified as provided in 291.21 to 291.27.

291.2 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 Assurance Engagements (HKSAEs) apply. For a description of the elements and objectives of an assurance engagement, refer to the Assurance Framework.

291.3 Compliance with the fundamental principle of objectivity requires being independent of assurance clients. In the case of assurance engagements, it is in the public interest and, therefore, required by this Code of Ethics, that members of assurance teams and firms be independent of assurance clients and that any threats that the firm has reason to believe are created by a network firm's interests and relationships be evaluated. In addition, when the assurance team knows or has reason to believe that a relationship or circumstance involving a related entity of the assurance client is relevant to the evaluation of the firm's independence from the client, the assurance team shall include that related entity when identifying and evaluating threats to independence and applying appropriate safeguards.

A Conceptual Framework Approach to Independence

291.4 The objective of this section is to assist firms and members of assurance teams in applying the conceptual framework approach described below to achieving and maintaining independence.

291.5 Independence comprises:

(a) Independence of Mind

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

(b) Independence in Appearance

The avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that a firm's, or a member of the assurance team's, integrity, objectivity or professional skepticism has been compromised.

291.6 The conceptual framework approach shall be applied by professional accountants to:

(a) Identify threats to independence;

(b) Evaluate the significance of the threats identified; and

(c) Apply safeguards when necessary to eliminate the threats or reduce them to an acceptable level.

When the professional accountant determines that appropriate safeguards are not available or cannot be applied to eliminate the threats or reduce them to an acceptable level, the professional accountant shall eliminate the circumstance or relationship creating the threats or decline or terminate the assurance engagement.

A professional accountant shall use professional judgment in applying this conceptual framework.

291.7 Many different circumstances, or combinations of circumstances, may be relevant in assessing threats to independence. It is impossible to define every situation that creates threats to independence and to specify the appropriate action. Therefore, this Code establishes a conceptual framework that requires firms and members of assurance teams to identify, evaluate, and address threats to independence. The conceptual framework approach assists professional accountants in public practice in complying with the ethical requirements in this Code. It accommodates many variations in circumstances that create threats to independence and can deter a professional accountant from concluding that a situation is permitted if it is not specifically prohibited.

291.8 Paragraphs 291.100 and onwards describe how the conceptual framework approach to independence is to be applied. These paragraphs do not address all the circumstances and relationships that create or may create threats to independence.

291.9 In deciding whether to accept or continue an engagement, or whether a particular individual may be a member of the assurance team, a firm shall identify and evaluate any threats to independence. If the threats are not at an acceptable level, and the decision is whether to accept an engagement or include a particular individual on the assurance team, the firm shall determine whether safeguards are available to eliminate the threats or reduce them to an acceptable level. If the decision is whether to continue an engagement, the firm shall determine whether any existing safeguards will continue to be effective to eliminate the threats or reduce them to an acceptable level or whether other safeguards will need to be applied or whether the engagement needs to be terminated. Whenever new information about a threat comes to the attention of the firm during the engagement, the firm shall evaluate the significance of the threat in accordance with the conceptual framework approach.

291.10 Throughout this section, reference is made to the significance of threats to independence. In evaluating the significance of a threat, qualitative as well as quantitative factors shall be taken into account.

291.11 This section does not, in most cases, prescribe the specific responsibility of individuals within the firm for actions related to independence because responsibility may differ depending on the size, structure and organization of a firm. The firm is required by Hong Kong Standards on Quality Control to establish policies and procedures designed to provide it with reasonable assurance that independence is maintained when required by relevant ethical standards.

Assurance Engagements

291.12 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.

291.13 The outcome of the evaluation or measurement of a subject matter is the information that results from applying the criteria to the subject matter. The term “subject matter information” is used to mean the outcome of the evaluation or measurement of a subject matter. For example, the Framework states that an assertion about the effectiveness of internal control (subject matter information) results from applying a framework for evaluating the effectiveness of internal control, such as COSO[2] or CoCo[3] (criteria), to internal control, a process (subject matter).

[2] “Internal Control – Integrated Framework” The Committee of Sponsoring Organizations of the Treadway Commission.

[3] “Guidance on Assessing Control – The CoCo Principles” Criteria of Control Board, The Canadian Institute of Chartered Accountants.

291.14 Assurance engagements may be assertion-based or direct reporting. In either case, they involve three separate parties: a professional accountant in public practice, a responsible party and intended users.

291.15 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.

291.16 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.

Assertion-Based Assurance Engagements

291.17 In an assertion-based assurance engagement, the members of the assurance team and the firm shall be independent of the assurance client (the party responsible for the subject matter information, and which may be responsible for the subject matter). Such independence requirements prohibit certain relationships between members of the assurance team and (a) directors or officers, and (b) individuals at the client in a position to exert significant influence over the subject matter information. Also, a determination shall be made as to whether threats to independence are created by relationships with individuals at the client in a position to exert significant influence over the subject matter of the engagement. An evaluation shall be made of the significance of any threats that the firm has reason to believe are created by network firm[4] interests and relationships.

291.18 In the majority of assertion-based assurance engagements, the responsible party is responsible for both the subject matter information and the subject matter. However, in some engagements, the responsible party 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).

291.19 In assertion-based assurance 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 shall be independent of the party responsible for the subject matter information (the assurance client). In addition, an evaluation shall be made of any threats the firm has reason to believe are 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

291.20 In a direct reporting assurance engagement, the members of the assurance team and the firm shall be independent of the assurance client (the party responsible for the subject matter). An evaluation shall also be made of any threats the firm has reason to believe are created by network firm interests and relationships.

Reports that Include a Restriction on Use and Distribution

291.21 In certain circumstances where the assurance report includes a restriction on use and distribution, and provided the conditions in this paragraph and in 291.22 are met, the independence requirements in this section may be modified. The modifications to the requirements of Section 291 are permitted if the intended users of the report (a) are knowledgeable as to the purpose, subject matter information and limitations of the report

[4] See paragraphs 290.13 to 290.24 for guidance on what constitutes a network firm.

and (b) explicitly agree to the application of the modified independence requirements. Knowledge as to the purpose, subject matter information, and limitations of the report may be obtained by the intended users through their participation, either directly or indirectly through their representative who has the authority to act for the intended users, in establishing the nature and scope of the engagement. Such participation enhances the ability of the firm to communicate with intended users about independence matters, including the circumstances that are relevant to the evaluation of the threats to independence and the applicable safeguards necessary to eliminate the threats or reduce them to an acceptable level, and to obtain their agreement to the modified independence requirements that are to be applied.

291.22 The firm shall communicate (for example, in an engagement letter) with the intended users regarding the independence requirements that are to be applied with respect to the provision of the assurance engagement. Where the intended users are a class of users (for example, lenders in a syndicated loan arrangement) who are not specifically identifiable by name at the time the engagement terms are established, such users shall subsequently be made aware of the independence requirements agreed to by the representative (for example, by the representative making the firm's engagement letter available to all users).

291.23 If the firm also issues an assurance report that does not include a restriction on use and distribution for the same client, the provisions of paragraphs 291.25 to 291.27 do not change the requirement to apply the provisions of paragraphs 291.1 to 291.156 to that assurance engagement. If the firm also issues an audit report, whether or not it includes a restriction on use and distribution, for the same client, the provisions of Section 290 shall apply to that audit engagement.

291.24 The modifications to the requirements of Section 291 that are permitted in the circumstances set out above are described in paragraphs 291.25 to 291.27. Compliance in all other respects with the provisions of Section 291 is required.

291.25 When the conditions set out in paragraphs 291.21 and 291.22 are met, the relevant provisions set out in paragraphs 291.104 to 291.132 apply to all members of the engagement team, and their immediate and close family members. In addition, a determination shall be made as to whether threats to independence are created by interests and relationships between the assurance client and the following other members of the assurance team:

- Those who provide consultation regarding technical or industry specific issues, transactions or events; and
- Those who provide quality control for the engagement, including those who perform the engagement quality control review.

An evaluation shall also be made, by reference to the provisions set out in paragraphs 291.104 to 291.132, of any threats that the engagement team has reason to believe are created by interests and relationships between the assurance client and others within the firm who can directly influence the outcome of the assurance engagement, including those who recommend the compensation, or who provide direct supervisory, management or other oversight, of the assurance engagement partner in connection with the performance of the assurance engagement.

291.26 Even though the conditions set out in paragraphs 291.21 to 291.22 are met, 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 that no safeguards could reduce the threat to an acceptable level. Accordingly, the firm shall not have such a financial interest. In addition, the firm shall comply with the other applicable provisions of this section described in paragraphs 291.112 to 291.156.

291.27 An evaluation shall also be made of any threats that the firm has reason to believe are created by network firm interests and relationships.

Multiple Responsible Parties

291.28 In some assurance engagements, whether assertion-based or direct reporting, there might be several responsible parties. In determining whether it is necessary to apply the provisions in this section to each responsible party in such engagements, 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 not trivial and inconsequential in the context of the subject matter information. This will take into account factors such as:

- The materiality of the subject matter information (or of 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 trivial and inconsequential, it may not be necessary to apply all of the provisions of this section to that responsible party.

Documentation

291.29 Documentation provides evidence of the professional accountant's judgments in forming conclusions regarding compliance with independence requirements. The absence of documentation is not a determinant of whether a firm considered a particular matter nor whether it is independent.

The professional accountant shall document conclusions regarding compliance with independence requirements, and the substance of any relevant discussions that support those conclusions. Accordingly:

(a) When safeguards are required to reduce a threat to an acceptable level, the professional accountant shall document the nature of the threat and the safeguards in place or applied that reduce the threat to an acceptable level; and

(b) When a threat required significant analysis to determine whether safeguards were necessary and the professional accountant concluded that they were not because the threat was already at an acceptable level, the professional accountant shall document the nature of the threat and the rationale for the conclusion.

Engagement Period

291.30 Independence from the assurance client is required both during the engagement period and the period covered by the subject matter information. The engagement period starts when the assurance team begins to perform assurance services with respect to the particular engagement. The engagement period ends when the assurance report is issued. When the engagement is of a recurring nature, it ends at the later of the notification by either party that the professional relationship has terminated or the issuance of the final assurance report.

291.31 When an entity becomes an assurance client during or after the period covered by the subject matter information on which the firm will express a conclusion, the firm shall determine whether any threats to independence are created by:

(a) Financial or business relationships with the assurance client during or after the period covered by the subject matter information but before accepting the assurance engagement; or

(b) Previous services provided to the assurance client.

291.32 If a non-assurance service was provided to the assurance client during or after the period covered by the subject matter information but before the assurance team begins to perform assurance services and the service would not be permitted during the period of the assurance engagement, the firm shall evaluate any threat to independence created by the service. If any threat is not at an acceptable level, the assurance engagement shall only be accepted if

safeguards are applied to eliminate any threats or reduce them to an acceptable level. Examples of such safeguards include:

- Not including personnel who provided the non-assurance service as members of the assurance team;
- Having a professional accountant review the assurance and non-assurance work as appropriate; or
- Engaging another firm to evaluate the results of the non-assurance service or having another firm re-perform the non-assurance service to the extent necessary to enable it to take responsibility for the service.

However, if the non-assurance service has not been completed and it is not practical to complete or terminate the service before the commencement of professional services in connection with the assurance engagement, the firm shall only accept the assurance engagement if it is satisfied:

(a) The non-assurance service will be completed within a short period of time; or

(b) The client has arrangements in place to transition the service to another provider within a short period of time.

During the service period, safeguards shall be applied when necessary. In addition, the matter shall be discussed with those charged with governance.

Breach of a Provision of this Section

291.33 When a breach of a provision of this section is identified, the firm shall terminate, suspend or eliminate the interest or relationship that caused the breach, and shall evaluate the significance of that breach and its impact on the firm's objectivity and ability to issue an assurance report. The firm shall determine whether action can be taken that satisfactorily addresses the consequences of the breach. In making this determination, the firm shall exercise professional judgment and take into account whether a reasonable and informed third party, weighing the significance of the breach, the action to be taken and all the specific facts and circumstances available to the professional accountant at that time, would be likely to conclude that the firm's objectivity would be compromised such that the firm is unable to issue an assurance report.

291.34 If the firm determines that action cannot be taken to satisfactorily address the consequences of the breach, the firm shall, as soon as possible, inform the party that engaged the firm or those charged with governance, as appropriate, and take the steps necessary to terminate the assurance engagement in compliance with any applicable legal or regulatory requirements relevant to terminating the assurance engagement.

291.35 If the firm determines that action can be taken to satisfactorily address the consequences of the breach, the firm shall discuss the breach and the action it has taken or proposes to take with the party that engaged the firm or those charged with governance, as appropriate. The firm shall discuss the breach and the proposed action on a timely basis, taking into account the circumstances of the engagement and the breach.

291.36 If the party that engaged the firm or those charged with governance, as appropriate, do not concur that the action satisfactorily addresses the consequences of the breach, the firm shall take the steps necessary to terminate the assurance engagement in compliance with any applicable legal or regulatory requirements relevant to terminating the assurance engagement.

291.37 The firm shall document the breach, the actions taken, key decisions made and all the matters discussed with the party that engaged the firm or those charged with governance. When the firm continues with the assurance engagement, the matters to be documented shall also include the conclusion that, in the firm's professional judgment, objectivity has not been compromised and the rationale for why the action taken satisfactorily addressed the consequences of the breach such that the firm could issue an assurance report.

Paragraphs 291.38 to 291.99 are intentionally left blank.

Application of the Conceptual Framework Approach to Independence

291.100 Paragraphs 291.104 to 291.156 describe specific circumstances and relationships that create or may create threats to independence. The paragraphs describe the potential threats and the types of safeguards that may be appropriate to eliminate the threats or reduce them to an acceptable level and identify certain situations where no safeguards could reduce the threats to an acceptable level. The paragraphs do not describe all of the circumstances and relationships that create or may create a threat to independence. The firm and the members of the assurance team shall evaluate the implications of similar, but different, circumstances and relationships and determine whether safeguards, including the safeguards in paragraphs 200.11 to 200.14 can be applied when necessary to eliminate the threats to independence or reduce them to an acceptable level.

291.101 The paragraphs demonstrate how the conceptual framework approach applies to assurance engagements and are to be read in conjunction with paragraph 291.28 which explains that, in the majority of assurance engagements, there is one responsible party and that responsible party is the assurance client. However, in some assurance engagements there are two or more responsible parties. In such circumstances, an evaluation shall be made of any threats the firm has reason to believe are 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. For assurance reports that include a restriction on use and distribution, the paragraphs are to be read in the context of paragraphs 291.21 to 291.27.

291.102 Interpretation 2005-01 provides further guidance on applying the independence requirements contained in this section to assurance engagements.

291.103 Paragraphs 291.104 to 291.119 contain references to the materiality of a financial interest, loan, or guarantee, or the significance of a business relationship. For the purpose of determining whether such an interest is material to an individual, the combined net worth of the individual and the individual's immediate family members may be taken into account.

Financial Interests

291.104 Holding a financial interest in an assurance client may create a self-interest threat. The existence and significance of any threat created depends on: (a) the role of the person holding the financial interest, (b) whether the financial interest is direct or indirect, and (c) the materiality of the financial interest.

291.105 Financial interests may be held through an intermediary (e.g. a collective investment vehicle, estate or trust). The determination of whether such financial interests are direct or indirect will depend upon whether the beneficial owner has control over the investment vehicle or the ability to influence its investment decisions. When control over the investment vehicle or the ability to influence investment decisions exists, this Code defines that financial interest to be a direct financial interest. Conversely, when the beneficial owner of the financial interest has no control over the investment vehicle or ability to influence its investment decisions, this Code defines that financial interest to be an indirect financial interest.

291.106 If a member of the assurance team, a member of that individual's immediate family, or a firm has a direct financial interest or a material indirect financial interest in the assurance client, the self-interest threat created would be so significant that no safeguards could reduce the threat to an acceptable level. Therefore, none of the following shall have a direct financial interest or a material indirect financial interest in the client: a member of the assurance team; a member of that individual's immediate family member; or the firm.

291.107 When a member of the assurance team has a close family member who the assurance team member knows has a direct financial interest or a material indirect financial interest in the assurance client, a self-interest threat is created. The significance of the threat will depend on factors such as

- The nature of the relationship between the member of the assurance team and the close family member; and
- The materiality of the financial interest to the close family member.

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

- The close family member disposing, as soon as practicable, of all of the financial interest or disposing of a sufficient portion of an indirect financial interest so that the remaining interest is no longer material;
- Having a professional accountant review the work of the member of the assurance team; or
- Removing the individual from the assurance team.

291.108 If a member of the assurance team, a member of that individual's immediate family, or a firm has a direct or material indirect financial interest in an entity that has a controlling interest in the assurance client, and the client is material to the entity, the self-interest threat created would be so significant that no safeguards could reduce the threat to an acceptable level. Therefore, none of the following shall have such a financial interest: a member of the assurance team; a member of that individual's immediate family; and the firm.

291.109 The holding by a firm or a member of the assurance team, or a member of that individual's immediate family, of a direct financial interest or a material indirect financial interest in the assurance client as a trustee creates a self-interest threat. Such an interest shall not be held unless:

(a) Neither the trustee, nor an immediate family member of the trustee, nor the firm are beneficiaries of the trust;

(b) The interest in the assurance client held by the trust is not material to the trust;

(c) The trust is not able to exercise significant influence over the assurance client; and

(d) The trustee, an immediate family member of the trustee, or the firm cannot significantly influence any investment decision involving a financial interest in the assurance client.

291.110 Members of the assurance team shall determine whether a self-interest threat is created by any known financial interests in the assurance client held by other individuals including:

- Partners and professional employees of the firm, other than those referred to above, or their immediate family members; and
- Individuals with a close personal relationship with a member of the assurance team.

Whether these interests create a self-interest threat will depend on 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 any threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:

- Removing the member of the assurance team with the personal relationship from the assurance team;
- Excluding the member of the assurance team from any significant decision-making concerning the assurance engagement; or
- Having a professional accountant review the work of the member of the assurance team.

291.111 If a firm, a member of the assurance team, or an immediate family member of the individual, receives a direct financial interest or a material indirect financial interest in an assurance client, for example, by way of an inheritance, gift or as a result of a merger, and such interest would not be permitted to be held under this section, then:

(a) If the interest is received by the firm, the financial interest shall be disposed of immediately, or a sufficient amount of an indirect financial interest shall be disposed of so that the remaining interest is no longer material, or

(b) If the interest is received by a member of the assurance team, or a member of that individual's immediate family, the individual who received the financial interest shall immediately dispose of the financial interest, or dispose of a sufficient amount of an indirect financial interest so that the remaining interest is no longer material.

Loans and Guarantees

291.112 A loan, or a guarantee of a loan, to a member of the assurance team, or a member of that individual's immediate family, or the firm from an assurance client that is a bank or a similar institution, may create a threat to independence. If the loan or guarantee is not made under normal lending procedures, terms and conditions, a self-interest threat would be created that would be so significant that no safeguards could reduce the threat to an acceptable level. Accordingly, neither a member of the assurance team, a member of that individual's immediate family, nor a firm shall accept such a loan or guarantee.

291.113 If a loan to a firm from an assurance client that is a bank or similar institution is made under normal lending procedures, terms and conditions and it is material to the assurance client or firm receiving the loan, it may be possible to apply safeguards to reduce the self-interest threat to an acceptable level. An example of such a safeguard is having the work reviewed by a professional accountant from a network firm that is neither involved with the assurance engagement nor received the loan.

291.114 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 a member of that individual's immediate family, does not create a threat to independence if the loan or guarantee is made under normal lending procedures, terms and conditions. Examples of such loans include home mortgages, bank overdrafts, car loans and credit card balances.

291.115 If the firm or a member of the assurance team, or a member of that individual's immediate family, accepts a loan from, or has a borrowing guaranteed by, an assurance client that is not a bank or similar institution, the self-interest threat created would be so significant that no safeguards 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 immediate family member, and the client.

291.116 Similarly, if the firm, or a member of the assurance team, or a member of that individual's immediate family, makes or guarantees a loan to an assurance client, the self-interest threat created would be so significant that no safeguards 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 immediate family member, and the client.

291.117 If a firm or a member of the assurance team, or a member of that individual's immediate family, has deposits or a brokerage account with an assurance client that is a bank, broker, or similar institution, a threat to independence is not created if the deposit or account is held under normal commercial terms.

Business Relationships

291.118 A close business relationship between a firm, or a member of the assurance team, or a member of that individual's immediate family, and the assurance client or its management arises from a commercial relationship or common financial interest and may create self-interest or intimidation threats. Examples of such relationships include:

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

Unless any financial interest is immaterial and the business relationship is insignificant to the firm and the client or its management, the threat created would be so significant that no safeguards could reduce the threat to an acceptable level. Therefore, unless the financial interest is immaterial and the business relationship is insignificant, the business relationship shall not be entered into, or shall be reduced to an insignificant level or terminated.

In the case of a member of the assurance team, unless any such financial interest is immaterial and the relationship is insignificant to that member, the individual shall be removed from the assurance team.

If the business relationship is between an immediate family member of a member of the assurance team and the assurance client or its management, the significance of any threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level.

291.119 The purchase of goods and services from an assurance client by the firm, or a member of the assurance team, or a member of that individual's immediate family, does not generally create a threat to independence if the transaction is in the normal course of business and at arm's length. However, such transactions may be of such a nature or magnitude that they create a self-interest threat. The significance of any threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:

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

Family and Personal Relationships

291.120 Family and personal relationships between a member of the assurance team and a director or officer or certain employees (depending on their role) of the assurance client, may create self-interest, familiarity or intimidation threats. The existence and significance of any threats will depend on a number of factors, including the individual's responsibilities on the assurance team, the role of the family member or other individual within the client, and the closeness of the relationship.

291.121 When an immediate family member of a member of the assurance team is:

(a) A director or officer of the assurance client, or

(b) An employee in a position to exert significant influence over the subject matter information of the assurance engagement,

or was in such a position during any period covered by the engagement or the subject matter information, 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 safeguards could reduce the threat to an acceptable level. Accordingly, no individual who has such a relationship shall be a member of the assurance team.

291.122 Threats to independence are created when an immediate family member of a member of the assurance team is an employee in a position to exert significant influence over the subject matter of the engagement. The significance of the threats will depend on factors such as:

- The position held by the immediate family member; and
- The role of the professional on the assurance team.

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

- Removing the individual from the assurance team; or
- 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.

291.123 Threats to independence are created when a close family member of a member of the assurance team is:

- A director or officer of the assurance client; or
- An employee in a position to exert significant influence over the subject matter information of the assurance engagement.

The significance of the threats will depend on factors such as:

- The nature of the relationship between the member of the assurance team and the close family member;
- The position held by the close family member; and
- The role of the professional on the assurance team.

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

- Removing the individual from the assurance team; or
- 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.

291.124 Threats to independence are created when a member of the assurance team has a close relationship with a person who is not an immediate or close family member, but who is a director or officer or an employee in a position to exert significant influence over the subject matter information of the assurance engagement. A member of the assurance team who has such a relationship shall consult in accordance with firm policies and procedures. The significance of the threats will depend on factors such as:

- The nature of the relationship between the individual and the member of the assurance team;
- The position the individual holds with the client; and
- The role of the professional on the assurance team.

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

- Removing the professional from the assurance team; or
- Structuring the responsibilities of the assurance team so that the professional does not deal with matters that are within the responsibility of the individual with whom the professional has a close relationship.

291.125 Self-interest, familiarity or intimidation threats may be created by a personal or family relationship between (a) a partner or employee of the firm who is not a member of the assurance team and (b) a director or officer of the assurance client or an employee in a position to exert significant influence over the subject matter information of the assurance engagement. The existence and significance of any threat will depend on factors such as:

- The nature of the relationship between the partner or employee of the firm and the director or officer or employee of the client;
- The interaction of the partner or employee of the firm with the assurance team;
- The position of the partner or employee within the firm; and
- The role of the individual within the client.

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

- Structuring the partner's or employee's responsibilities to reduce any potential influence over the assurance engagement; or
- Having a professional accountant review the relevant assurance work performed.

Employment with Assurance Clients

291.126 Familiarity or intimidation threats may be created if a director or officer of the assurance client, or an employee who is in a position to exert significant influence over the subject matter information of the assurance engagement, has been a member of the assurance team or partner of the firm.

291.127 If a former member of the assurance team or partner of the firm has joined the assurance client in such a position, the existence and significance of any familiarity or intimidation threats will depend on factors such as:

- The position the individual has taken at the client;
- Any involvement the individual will have with the assurance team;
- The length of time since the individual was a member of the assurance team or partner of the firm; and
- The former position of the individual within the assurance team or firm, for example, whether the individual was responsible for maintaining regular contact with the client's management or those charged with governance.

In all cases the individual shall not continue to participate in the firm's business or professional activities.

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

- Making arrangements such that the individual is not entitled to any benefits or payments from the firm, unless made in accordance with fixed pre-determined arrangements.

- Making arrangements such that any amount owed to the individual is not material to the firm;
- Modifying the plan for the assurance engagement;
- Assigning individuals to the assurance team who have sufficient experience in relation to the individual who has joined the client; or
- Having a professional accountant review the work of the former member of the assurance team.

291.128 If a former partner of the firm has previously joined an entity in such a position and the entity subsequently becomes an assurance client of the firm, the significance of any threats to independence shall be evaluated and safeguards applied when necessary, to eliminate the threat or reduce it to an acceptable level.

291.129 A self-interest threat is created when a member of the assurance team participates in the assurance engagement while knowing that the member of the assurance team will, or may, join the client some time in the future. Firm policies and procedures shall require members of an assurance team to notify the firm when entering employment negotiations with the client. On receiving such notification, the significance of the threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:

- Removing the individual from the assurance team; or
- A review of any significant judgments made by that individual while on the team.

Recent Service with an Assurance Client

291.130 Self-interest, self-review or familiarity threats may be created if a member of the assurance team has recently served as a director, officer, or employee of the assurance client. This would be the case when, for example, a member of the assurance team has to evaluate elements of the subject matter information the member of the assurance team had prepared while with the client.

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

291.132 Self-interest, self-review or familiarity threats may be created if, before the period covered by the assurance report, a member of the assurance team had served as director or officer of the assurance client, or was an employee in a position to exert significant influence over the subject matter information of the assurance engagement. 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 client, is to be evaluated in the current period as part of the current assurance engagement. The existence and significance of any threats will depend on factors such as:

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

The significance of any threat shall be evaluated and safeguards applied when necessary to reduce the threat to an acceptable level. An example of such a safeguard is conducting a review of the work performed by the individual as part of the assurance team.

Serving as a Director or Officer of an Assurance Client

291.133 If a partner or employee of the firm serves a director or officer of an assurance client, the self-review and self-interest threats would be so significant that no safeguards could reduce the threats to an acceptable level. Accordingly, no partner or employee shall serve as a director or officer of an assurance client.

291.134 The position of Company Secretary has different implications in different jurisdictions. Duties may range from administrative duties, such as personnel management and the maintenance of company records and registers, to duties as diverse as ensuring that the company complies with regulation or providing advice on corporate governance matters. Generally, this position is seen to imply a close association with the entity.

291.135 If a partner or employee of the firm serves as Company Secretary for an assurance client, self-review and advocacy threats are created that would generally be so significant that no safeguards could reduce the threats to an acceptable level. Despite paragraph 291.133, when this practice is specifically permitted under local law, professional rules or practice, and provided management makes all relevant decisions, the duties and activities shall be limited to those of a routine and administrative nature, such as preparing minutes and maintaining statutory returns. In those circumstances, the significance of any threats shall be evaluated and safeguards applied when necessary to eliminate the threats or reduce them to an acceptable level.

291.136 Performing routine administrative services to support a company secretarial function or providing advice in relation to company secretarial administration matters does not generally create threats to independence, as long as client management makes all relevant decisions.

Long Association of Senior Personnel with an Assurance Client

291.137 Familiarity and self-interest threats are created by using the same senior personnel on an assurance engagement over a long period of time. The significance of the threats will depend on factors such as:

- How long the individual has been a member of the assurance team;
- The role of the individual on the assurance team;
- The structure of the firm;
- The nature of the assurance engagement;
- Whether the client's management team has changed; and
- Whether the nature or complexity of the subject matter information has changed.

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

- Rotating the senior personnel off the assurance team;
- Having a professional accountant who was not a member of the assurance team review the work of the senior personnel; or
- Regular independent internal or external quality reviews of the engagement.

Provision of Non-assurance Services to an Assurance Client

291.138 Firms have traditionally provided to their assurance clients a range of non-assurance services that are consistent with their skills and expertise. Providing non-assurance services may, however, create threats to the independence of the firm or members of the assurance team. The threats created are most often self-review, self-interest and advocacy threats.

291.139 When specific guidance on a particular non-assurance service is not included in this section, the conceptual framework shall be applied when evaluating the particular circumstances.

291.140 Before the firm accepts an engagement to provide a non-assurance service to an assurance client, a determination shall be made as to whether providing such a service would create a threat to independence. In evaluating the significance of any threat created by a particular non-assurance service, consideration shall be given to any threat that the assurance team has reason to believe is created by providing other related non-assurance services. If a threat is created that cannot be reduced to an acceptable level by the application of safeguards the non-assurance service shall not be provided.

Management Responsibilities

291.141 Management responsibilities involve controlling, leading and directing an entity, including making decisions regarding the acquisition, deployment and control of human, financial, technological, physical and intangible resources.

291.142 Determining whether an activity is a management responsibility depends on the circumstances and requires the exercise of judgment. Examples of activities that would be considered a management responsibility include:

- Setting policies and strategic direction.
- Hiring or dismissing employees.
- Directing and taking responsibility for the actions of employees in relation to the employees' work for the entity.
- Authorizing transactions.
- Control or management of bank accounts or investments.
- Deciding which recommendations of the firm or other third parties to implement.
- Reporting to those charged with governance on behalf of management.
- Taking responsibility for designing, implementing, monitoring or maintaining internal controls.

291.143 In providing assurance services to an assurance client, a firm shall not assume a management responsibility as part of the assurance service. If the firm were to assume a management responsibility as part of the assurance service, the threats created would be so significant that no safeguards could reduce the threats to an acceptable level. If the firm assumes a management responsibility as part of any other services provided to the assurance client, the firm shall ensure that the responsibility is not related to the subject matter or subject matter information of the assurance engagement provided by the firm.

291.144 When providing services that are related to the subject matter or subject matter information of an assurance engagement provided by the firm, the firm shall be satisfied that client management makes all judgments and decisions relating to the subject matter or subject matter information of the assurance engagement that are the responsibility of management. This includes ensuring that the client's management:

- Designates an individual who possesses suitable skill, knowledge and experience to be responsible at all times for the client's decisions and to oversee the services. Such an individual, preferably within senior management, would understand the objectives, nature and results of the services and the respective client and firm responsibilities. However, the individual is not required to possess the expertise to perform or re-perform the services;
- Provides oversight of the services and evaluates the adequacy of the results of the services performed for the client's purpose; and

- Accepts responsibility for the actions, if any, to be taken arising from the results of the services.

Other Considerations

291.145 Threats to independence may be created when a firm provides a non-assurance service related to the subject matter information of an assurance engagement. In such cases, an evaluation of the significance of the firm's involvement with the subject matter information of the engagement shall be made, and a determination shall be made of whether any self-review threats that are not at an acceptable level can be reduced to an acceptable level by the application of safeguards.

291.146 A self-review threat may be created if the firm is involved in the preparation of subject matter information which is subsequently the subject matter information of an assurance engagement. For example, a self-review threat would be created if the firm developed and prepared prospective financial information and subsequently provided assurance on this information. Consequently, the firm shall evaluate the significance of any self-review threat created by the provision of such services and apply safeguards when necessary to eliminate the threat or reduce it to an acceptable level.

291.147 When a firm performs a valuation that forms part of the subject matter information of an assurance engagement, the firm shall evaluate the significance of any self-review threat and apply safeguards when necessary to eliminate the threat or reduce it to an acceptable level.

Fees

Fees—Relative Size

291.148 When the total fees from an assurance client represent a large proportion of the total fees of the firm expressing the conclusion, the dependence on that client and concern about losing the client creates a self-interest or intimidation threat. The significance of the threat will depend on factors such as:

- The operating structure of the firm;
- Whether the firm is well established or new; and
- The significance of the client qualitatively and/or quantitatively to the firm.

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

- Reducing the dependency on the client;
- External quality control reviews; or
- Consulting a third party, such as a professional regulatory body or a professional accountant, on key assurance judgments.

291.149 A self-interest or intimidation threat is also created when the fees generated from an assurance client represent a large proportion of the revenue from an individual partner's clients. The significance of the threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. An example of such a safeguard is having an additional professional accountant who was not a member of the assurance team review the work or otherwise advise as necessary.

Fees—Overdue

291.150 A self-interest threat may be created if fees due from an assurance client remain unpaid for a long time, especially if a significant part is not paid before the issue of the assurance report, if any, for the following period. Generally the firm is expected to require payment of

such fees before any such report is issued. If fees remain unpaid after the report has been issued, the existence and significance of any threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. An example of such a safeguard is having another professional accountant who did not take part in the assurance engagement provide advice or review the work performed. The firm shall determine 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 or continue the assurance engagement.

Contingent Fees

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

291.152 A contingent fee charged directly or indirectly, for example through an intermediary, by a firm in respect of an assurance engagement creates a self-interest threat that is so significant that no safeguards could reduce the threat to an acceptable level. Accordingly, a firm shall not enter into any such fee arrangement.

291.153 A contingent fee charged directly or indirectly, for example through an intermediary, by a firm in respect of a non-assurance service provided to an assurance client may also create a self-interest threat. If the outcome of the non-assurance service, and therefore, the amount of the fee, is dependent on a future or contemporary judgment related to a matter that is material to the subject matter information of the assurance engagement, no safeguards could reduce the threat to an acceptable level. Accordingly, such arrangements shall not be accepted.

291.154 For other contingent fee arrangements charged by a firm for a non-assurance service to an assurance client, the existence and significance of any threats will depend on factors such as:

- The range of possible fee amounts;
- Whether an appropriate authority determines the outcome of the matter upon which the contingent fee will be determined;
- The nature of the service; and
- The effect of the event or transaction on the subject matter information.

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

- Having a professional accountant review the relevant assurance work or otherwise advise as necessary; or
- Using professionals who are not members of the assurance team to perform the non-assurance service.

Gifts and Hospitality

291.155 Accepting gifts or hospitality from an assurance client may create self-interest and familiarity threats. If a firm or a member of the assurance team accepts gifts or hospitality, unless the value is trivial and inconsequential, the threats created would be so significant that no safeguards could reduce the threats to an acceptable level. Consequently, a firm or a member of the assurance team shall not accept such gifts or hospitality.

Actual or Threatened Litigation

291.156 When litigation takes place, or appears likely, between the firm or a member of the assurance team and the assurance client, self-interest and intimidation threats are 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. When the firm and the client's management are placed in adversarial positions by actual or threatened litigation, affecting management's willingness to make complete disclosures self-interest and intimidation threats are created. The significance of the threats created will depend on such factors as:

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

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

- If the litigation involves a member of the assurance team, removing that individual from the assurance team; or
- Having a professional review the work performed.

If such safeguards do not reduce the threats to an acceptable level, the only appropriate action is to withdraw from, or decline, the assurance engagement.

Interpretation 2005-01 (Revised June 2010 to conform to changes resulting from the IESBA's project to improve the clarity of the Code)

Application of Section 291 to Assurance Engagements that are Not Financial Statement Audit Engagements

This interpretation provides guidance on the application of the independence requirements contained in Section 291 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 291 that are relevant in the consideration of independence requirements for all assurance engagements. For example, paragraph 291.3 states that an evaluation shall be made of any threats the firm has reason to believe are created by a network firm's interests and relationships. It also states that 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 shall include the related entity when evaluating threats to independence and when necessary applying safeguards. These matters are not specifically addressed in this interpretation.

As explained in the Hong Kong Framework for Assurance Engagements issued by the Hong Kong Institute of Certified Public Accountants, 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, an evaluation shall be made of any threats the firm has reason to believe are 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 291 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 not trivial and inconsequential 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 trivial and inconsequential it may not be necessary to apply all of the provisions of this section to that responsible party.

Example

The following example has been developed to demonstrate the application of Section 291. 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 31 December 20X0 were as follows:

	Proven oil reserves thousands of 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 not at an acceptable level. 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 291.28.)

For example Company 8 accounts for 0.17% of the total reserves, therefore a business relationship or interest with 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 that would be considered to be the assurance client (paragraph 291.28).

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

The firm shall be independent of the entity that measures the reserves and provides an assertion to the firm and to intended users (paragraph 291.19). That entity is not responsible for the subject matter and so an evaluation shall be made of any threats the firm has reason to believe are created by interests/relationships with the party responsible for the subject matter (paragraph 291.19). There are several parties responsible for the 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 not at an acceptable level.

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 not at an acceptable level. 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 291.28).

For example, Company 8 accounts for 0.17% of the reserves, therefore a business relationship or interest with 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 shall be independent of those responsible parties that would be considered to be the assurance client (paragraph 291.28).

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

Pages

Section 300 Introduction 110-112
Section 310 Conflicts of Interests 113-114
Section 320 Preparation and Reporting of Information 115
Section 330 Acting with Sufficient Expertise 116
Section 340 Financial Interests, Compensation and Incentives Linked to Financial Reporting and Decision Making 117-118
Section 350 Inducements 119-120
Section 360 Responding to Non-Compliance with Laws and Regulations…… 121-127

SECTION 300

Introduction

300.1 This Part of the Code describes how the conceptual framework contained in Part A applies in certain situations to professional accountants in business. This Part does not describe all of the circumstances and relationships that could be encountered by a professional accountant in business that create or may create threats to compliance with the fundamental principles. Therefore, the professional accountant in business is encouraged to be alert for such circumstances and relationships.

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 the accountant's employing organization. This Code does not seek to hinder a professional accountant in business from properly fulfilling that responsibility, but addresses circumstances in which compliance with the fundamental principles may be compromised.

300.5 A professional accountant in business may hold 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 behavior.

300.6 A professional accountant in business shall not knowingly 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 fundamental principles.

300.7 Compliance with the fundamental principles may potentially be threatened by a broad range of circumstances and relationships. Threats fall into one or more of 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:

- Holding a financial interest in, or receiving a loan or guarantee from the employing organization.
- Participating in incentive compensation arrangements offered by the employing organization.

- Inappropriate personal use of corporate assets.
- Concern over employment security.
- Commercial pressure from outside the employing organization.

300.9 An example of a circumstance that creates a self-review threat for a professional accountant in business is determining the appropriate accounting treatment for a business combination after performing the feasibility study that supported the acquisition decision.

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 for a professional accountant in business include:

- Being responsible for the employing organization's financial reporting when an immediate or close family member employed by the entity makes decisions that affect the entity's financial reporting.
- Long association with business contacts influencing business decisions.
- Accepting a gift or preferential treatment, unless the value is trivial and inconsequential.

300.12 Examples of circumstances that may create intimidation threats for a professional accountant in business include:

- 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 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 detailed in paragraph 100.14 of Part A of this Code.

300.14 Safeguards in the work environment include:

- 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 behavior 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.

300.15 In circumstances where a professional accountant in business believes that unethical behavior or actions by others will continue to occur within the employing organization, the professional accountant in business may consider obtaining 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

Conflicts of Interest

310.1 A professional accountant in business may be faced with a conflict of interest when undertaking a professional activity. A conflict of interest creates a threat to objectivity and may create threats to the other fundamental principles. Such threats may be created when:

- The professional accountant undertakes a professional activity related to a particular matter for two or more parties whose interests with respect to that matter are in conflict; or
- The interests of the professional accountant with respect to a particular matter and the interests of a party for whom the professional accountant undertakes a professional activity related to that matter are in conflict.

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

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

310.2 Examples of situations in which conflicts of interest may arise include:

- Serving in a management or governance position for two employing organizations and acquiring confidential information from one employing organization that could be used by the professional accountant to the advantage or disadvantage of the other employing organization.
- Undertaking a professional activity for each of two parties in a partnership employing the professional accountant to assist them to dissolve their partnership.
- Preparing financial information for certain members of management of the entity employing the professional accountant who are seeking to undertake a management buy-out.
- Being responsible for selecting a vendor for the accountant's employing organization when an immediate family member of the professional accountant could benefit financially from the transaction.
- Serving in a governance capacity in an employing organization that is approving certain investments for the company where one of those specific investments will increase the value of the personal investment portfolio of the professional accountant or an immediate family member.

310.3 When identifying and evaluating the interests and relationships that might create a conflict of interest and implementing safeguards, when necessary, to eliminate or reduce any threat to compliance with the fundamental principles to an acceptable level, a professional accountant in business shall exercise professional judgment and be alert to all interests and relationships that a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at the time, would be likely to conclude might compromise compliance with the fundamental principles.

310.4 When addressing a conflict of interest, a professional accountant in business is encouraged to seek guidance from within the employing organization or from others, such as a professional body, legal counsel or another professional accountant. When making disclosures or sharing information within the employing organization and seeking guidance of third parties, the professional accountant shall remain alert to the fundamental principle of confidentiality.

310.5 If the threat created by a conflict of interest is not at an acceptable level, the professional accountant in business shall apply safeguards to eliminate the threat or reduce it to an acceptable level. If safeguards cannot reduce the threat to an acceptable level, the

professional accountant shall decline to undertake or discontinue the professional activity that would result in the conflict of interest; or shall terminate the relevant relationships or dispose of relevant interests to eliminate the threat or reduce it to an acceptable level.

310.6 In identifying whether a conflict of interest exists or may be created, a professional accountant in business shall take reasonable steps to determine:

- The nature of the relevant interests and relationships between the parties involved; and
- The nature of the activity and its implication for relevant parties.

The nature of the activities and the relevant interests and relationships may change over time. The professional accountant shall remain alert to such changes for the purposes of identifying circumstances that might create a conflict of interest.

310.7 If a conflict of interest is identified, the professional accountant in business shall evaluate:

- The significance of relevant interests or relationships; and
- The significance of the threats created by undertaking the professional activity or activities. In general, the more direct the connection between the professional activity and the matter on which the parties' interests are in conflict, the more significant the threat to objectivity and compliance with the other fundamental principles will be.

310.8 The professional accountant in business shall apply safeguards, when necessary, to eliminate the threats to compliance with the fundamental principles created by the conflict of interest or reduce them to an acceptable level. Depending on the circumstances giving rise to the conflict of interest, application of one or more of the following safeguards may be appropriate:

- Restructuring or segregating certain responsibilities and duties.
- Obtaining appropriate oversight, for example, acting under the supervision of an executive or non-executive director.
- Withdrawing from the decision-making process related to the matter giving rise to the conflict of interest.
- Consulting with third parties, such as a professional body, legal counsel or another professional accountant.

310.9 In addition, it is generally necessary to disclose the nature of the conflict to the relevant parties, including to the appropriate levels within the employing organization and, when safeguards are required to reduce the threat to an acceptable level, to obtain their consent to the professional accountant in business undertaking the professional activity. In certain circumstances, consent may be implied by a party's conduct where the professional accountant has sufficient evidence to conclude that parties know the circumstances at the outset and have accepted the conflict of interest if they do not raise an objection to the existence of the conflict.

310.10 When disclosure is verbal, or consent is verbal or implied, the professional accountant in business is encouraged to document the nature of the circumstances giving rise to the conflict of interest, the safeguards applied to reduce the threats to an acceptable level and the consent obtained.

310.11 A professional accountant in business may encounter other threats to compliance with the fundamental principles. This may occur, for example, when preparing or reporting financial information as a result of undue pressure from others within the employing organization or financial, business or personal relationships that close or immediate family members of the professional accountant have with the employing organization. Guidance on managing such threats is covered by Sections 320 and 340 of the Code.

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's discussion and analysis, and the management letter of representation provided to the auditors during the audit of the entity's financial statements. A professional accountant in business shall 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 shall be satisfied that those financial statements are presented in accordance with the applicable financial reporting standards.

320.3 A professional accountant in business shall take reasonable steps to 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 integrity, objectivity or professional competence and due care, are created where a professional accountant in business is pressured (either externally or by the possibility of personal gain) to prepare or report information in a misleading way 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 corporate culture within the employing organization. The professional accountant in business shall be alert to the principle of integrity, which imposes an obligation on all professional accountants to be straightforward and honest in all professional and business relationships. Where the threats arise from compensation and incentive arrangements, the guidance in section 340 is relevant.

320.6 The significance of any threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards include consultation with superiors within the employing organization, the audit committee or those charged with governance of the organization, or with a relevant professional body.

320.7 Where it is not possible to reduce the threat to an acceptable level, a professional accountant in business shall refuse to be or remain associated with information the professional accountant determines is misleading. A professional accountant in business may have been unknowingly associated with misleading information. Upon becoming aware of this, the professional accountant in business shall take steps to be disassociated from that information. In determining whether there is a requirement to report the circumstances outside the organization, the professional accountant in business may consider obtaining legal advice. In addition, the professional accountant may consider whether to 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 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 shall not intentionally mislead an employer as to the level of expertise or experience possessed, nor shall a professional accountant in business fail to seek appropriate expert advice and assistance when required.

330.2 Circumstances that create a threat to a professional accountant in business performing duties with the appropriate degree of professional competence and due care include having:

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

- 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 When threats cannot be eliminated or reduced to an acceptable level, professional accountants in business shall determine 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 shall be clearly communicated.

SECTION 340

Financial Interests, Compensation and Incentives Linked to Financial Reporting and Decision Making

340.1 Professional accountants in business may have financial interests, including those arising from compensation or incentive arrangements, or may know of financial interests of immediate or close family members, that, in certain circumstances, may create 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 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, deferred bonus share entitlements or share options in the employing organization, the value of which could be directly affected by decisions made by the professional accountant in business.
- Otherwise participates in compensation arrangements which provide incentives to achieve performance targets or to support efforts to maximize the value of the employing organization's shares, for example, through participation in long-term incentive plans which are linked to certain performance conditions being met.

340.2 Self-interest threats arising from compensation or incentive arrangements may be further compounded by pressure from superiors or peers in the employing organization who participate in the same arrangements. For example, such arrangements often entitle participants to be awarded shares in the employing organization at little or no cost to the employee provided certain performance criteria are met. In some cases, the value of the shares awarded may be significantly greater than the base salary of the professional accountant in business.

340.3 A professional accountant in business shall not manipulate information or use confidential information for personal gain or for the financial gain of others. The more senior the position that the professional accountant in business holds, the greater the ability and opportunity to influence financial reporting and decision making and the greater the pressure there might be from superiors and peers to manipulate information. In such situations, the professional accountant in business shall be particularly alert to the principle of integrity, which imposes an obligation on all professional accountants to be straightforward and honest in all professional and business relationships.

340.4 The significance of any threat created by financial interests, shall be evaluated and safeguards applied, when necessary, to eliminate the threat or reduce it to an acceptable level. In evaluating the significance of any threat, and, when necessary, determining the appropriate safeguards to be applied, a professional accountant in business shall evaluate the nature of the interest. This includes evaluating the significance of the interest. What constitutes a significant interest will depend on personal circumstances. Examples of such safeguards 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 exercise entitlements or 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.
- Up-to-date education on ethical issues and on the legal restrictions and other regulations around potential insider trading.

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 shall be evaluated. Self-interest threats to objectivity or confidentiality are created when an inducement is made in an attempt to unduly influence actions or decisions, encourage illegal or dishonest behavior, 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 existence and significance of any threats will depend on the nature, value and intent behind the offer. If a reasonable and informed third party, weighing all the specific facts and circumstances, would consider the inducement insignificant and not intended to encourage unethical behavior, then a professional accountant in business may conclude that the offer is made in the normal course of business and may generally conclude that there is no significant threat to compliance with the fundamental principles.

350.4 The significance of any threats shall be evaluated and safeguards applied when 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 shall 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 shall be adopted. A professional accountant in business shall evaluate any threats created by such offers and determine whether to take one or more of the following actions:

(a) Informing higher levels of management or those charged with governance of the employing organization immediately when such offers have been made;

(b) Informing 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 may however, consider seeking legal advice before taking such a step; and

(c) Advising 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) Informing 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, or is under other pressure, to offer inducements to influence the judgment or decision-making process of an individual or organization, 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 shall 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 shall follow the principles and guidance regarding ethical conflict resolution set out in Part A of this Code.

SECTION 360

Responding to Non-Compliance with Laws and Regulations

Purpose

360.1 A professional accountant in business may encounter or be made aware of non-compliance or suspected non-compliance with laws and regulations in the course of carrying out professional activities. The purpose of this section is to set out the professional accountant's responsibilities when encountering such non-compliance or suspected non-compliance, and guide the professional accountant in assessing the implications of the matter and the possible courses of action when responding to it. This section applies regardless of the nature of the employing organization, including whether or not it is a public interest entity.

360.2 Non-compliance with laws and regulations ("non-compliance") comprises acts of omission or commission, intentional or unintentional, committed by the professional accountant's employing organization or by those charged with governa nce, by management, or by other individuals working for or under the direction of the employing organization which are contrary to the prevailing laws or regulations.

360.3 In some jurisdictions, there are legal or regulatory provisions governing how professional accountants should address non-compliance or suspected non-compliance which may differ from or go beyond this section. When encountering such non-compliance or suspected non-compliance, the professional accountant has a responsibility to obtain an understanding of those provisions and comply with them, including any requirement to report the matter to an appropriate authority and any prohibition on alerting the relevant party prior to making any disclosure, for example, pursuant to anti-money laundering legislation.

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

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

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

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

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

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

Scope

360.5 This section sets out the approach to be taken by a professional accountant who encounters or is made aware of non-compliance or suspected non-compliance with:

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

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

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

- Fraud, corruption and bribery.

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

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

360.8 A professional accountant who encounters or is made aware of matters that are clearly inconsequential, judged by their nature and their impact, financial or otherwise, on the employing organization, its stakeholders and the general public, is not required to comply with this section with respect to such matters.

360.9 This section does not address:

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

(b) Non-compliance other than by the employing organization or those charged with governance, management, or other individuals working for or under the direction of the employing organization.

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

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

360.10 It is the responsibility of the employing organization's management, with the oversight of those charged with governance, to ensure that the employing organization's business activities are conducted in accordance with laws and regulations. It is also the responsibility of management and those charged with governance to identify and address any non-compliance by the employing organization or by an individual charged with governance of the entity, by a member of management, or by other individuals working for or under the direction of the employing organization.

Responsibilities of Professional Accountants in Business

360.11 Many employing organizations have established protocols and procedures (for example, an ethics policy or internal whistle-blowing mechanism) regarding how non-compliance or suspected non-compliance by the employing organization should be raised internally. Such protocols and procedures may allow for matters to be reported anonymously through designated channels. If these protocols and procedures exist within the professional accountant's employing organization, the professional accountant shall consider them in determining how to respond to such non-compliance.

360.12 Where a professional accountant becomes aware of a matter to which this section applies, the steps that the professional accountant takes to comply with this section shall be taken

on a timely basis, having regard to the professional accountant's understanding of the nature of the matter and the potential harm to the interests of the employing organization, investors, creditors, employees or the general public.

Responsibilities of Senior Professional Accountants in Business

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

Obtaining an Understanding of the Matter

360.14 If, in the course of carrying out professional activities, a senior professional accountant becomes aware of information concerning an instance of non-compliance or suspected non-compliance, the professional accountant shall obtain an understanding of the matter, including:

(a) The nature of the act and the circumstances in which it has occurred or may occur;

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

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

360.15 A senior professional accountant is expected to apply knowledge, professional judgment and expertise, but is not expected to have a level of understanding of laws and regulations beyond that which is required for the professional accountant's role within the employing organization. Whether an act constitutes non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body. Depending on the nature and significance of the matter, the professional accountant may cause, or take appropriate steps to cause, the matter to be investigated internally. The professional accountant may also consult on a confidential basis with others within the employing organization or a professional body, or with legal counsel.

Addressing the Matter

360.16 If the senior professional accountant identifies or suspects that non-compliance has occurred or may occur, the professional accountant shall, subject to paragraph 360.11, discuss the matter with the professional accountant's immediate superior, if any, to enable a determination to be made as to how the matter should be addressed. If the professional accountant's immediate superior appears to be involved in the matter, the professional accountant shall discuss the matter with the next higher level of authority within the employing organization.

360.17 The senior professional accountant shall also take appropriate steps to:

(a) Have the matter communicated to those charged with governance to obtain their concurrence regarding appropriate actions to take to respond to the matter and to enable them to fulfill their responsibilities;

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

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

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

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

360.18 In addition to responding to the matter in accordance with the provisions of this section, the senior professional accountant shall determine whether disclosure of the matter to the employing organization's external auditor, if any, is needed pursuant to the professional accountant's duty or legal obligation to provide all information necessary to enable the auditor to perform the audit.

Determining Whether Further Action Is Needed

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

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

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

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

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

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

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

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

360.24 In determining the need for, and nature and extent of any further action needed, the senior professional accountant shall exercise professional judgment and take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at the time, would be likely to conclude that the professional accountant has acted appropriately in the public interest.

360.25 Further action by the professional accountant may include:

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

360.26 Where the senior professional accountant determines that resigning from the employing organization would be appropriate, doing so would not be a substitute for taking other actions that may be needed to achieve the professional accountant's objectives under this section. In some jurisdictions, however, there may be limitations as to the further actions available to the professional accountant and resignation may be the only available course of action.

360.27 As consideration of the matter may involve complex analysis and judgments, the senior professional accountant may consider consulting internally, obtaining legal advice to understand the professional accountant's options and the professional or legal implications of taking any particular course of action, or consulting on a confidential basis with a regulator or professional body.

Determining Whether to Disclose the Matter to an Appropriate Authority

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

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

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

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

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

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

360.30 If the senior professional accountant determines that disclosure of the matter to an appropriate authority is an appropriate course of action in the circumstances, this will not be considered a breach of the duty of confidentiality under Section 140 of this Code. When making such disclosure, the professional accountant shall act in good faith and exercise caution when making statements and assertions.

360.31 In exceptional circumstances, the senior professional accountant may become aware of actual or intended conduct that the professional accountant has reason to believe would constitute an imminent breach of a law or regulation that would cause substantial harm to investors, creditors, employees or the general public. Having considered whether it would be appropriate to discuss the matter with management or those charged with governance of the entity, the professional accountant shall exercise professional judgment and may immediately disclose the matter to an appropriate authority in order to prevent or mitigate the consequences of such imminent breach of law or regulation. Such disclosure will not be considered a breach of the duty of confidentiality under Section 140 of this Code.

Documentation

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

- The matter.
- The results of discussions with the professional accountant's superiors, if any, and those charged with governance and other parties.
- How the professional accountant's superiors, if any, and those charged with governance have responded to the matter.
- The courses of action the professional accountant considered, the judgments made and the decisions that were taken.
- How the professional accountant is satisfied that the professional accountant has fulfilled the responsibility set out in paragraph 360.21.

Responsibilities of Professional Accountants Other than Senior Professional Accountants in Business

360.33 If, in the course of carrying out professional activities, a professional accountant becomes aware of information concerning an instance of non-compliance or suspected non-compliance, the professional accountant shall seek to obtain an understanding of the matter, including the nature of the act and the circumstances in which it has occurred or may occur.

360.34 The professional accountant is expected to apply knowledge, professional judgment and expertise, but is not expected to have a level of understanding of laws and regulations beyond that which is required for the professional accountant's role within the employing organization. Whether an act constitutes non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body. Depending on the nature and significance of the matter, the professional accountant may consult on a confidential basis with others within the employing organization or a professional body, or with legal counsel.

360.35 If the professional accountant identifies or suspects that non-compliance has occurred or may occur, the professional accountant shall, subject to paragraph 360.11, inform an immediate superior to enable the superior to take appropriate action. If the professional accountant's immediate superior appears to be involved in the matter, the professional accountant shall inform the next higher level of authority within the employing organization.

360.36 In exceptional circumstances, the professional accountant may decide that disclosure of the matter to an appropriate authority is an appropriate course of action. If the professional accountant does so pursuant to paragraph 360.29, this will not be considered a breach of the duty of confidentiality under Section 140 of this Code. When making such disclosure, the professional accountant shall act in good faith and exercise caution when making statements and assertions.

Documentation

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

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

Additional requirements are set out in Section 411 "Unlawful Acts or Defaults by or on behalf of a Member's Employer".

PART D: ADDITIONAL ETHICAL REQUIREMENTS

		Pages
Section 400	Introduction	129
Section 410	Unlawful Acts or Defaults by Clients of Members	130-148
Section 411	Unlawful Acts or Defaults by or on Behalf of a Member's Employer	149-152
Section 420	Use of Designations and Institute's Logo	153-154
Section 430	Ethics in Tax Practice	155-156
Section 431	Corporate Finance Advice	157-165
Section 440	Changes in a Professional Appointment	166-173
Section 441	Change of Auditors of a Listed Issuer of The Stock Exchange of Hong Kong	174-177
Section 450	Practice Promotion	178-181
Section 460	Clients' Monies	182-183

SECTION 400

Introduction

400.1 This Part of the Code sets out the additional ethical requirements on specific areas. Where the Council of the Institute deems it necessary, it has included, and may develop further, additional ethical requirements on matters of relevance not covered by the IESBA Code of Ethics for Professional Accountants. The existing additional ethical requirements are primarily derived from local legal or regulatory requirements.

400.2 The sections under this Part are to be read in the context of the fundamental principles of professional ethics for professional accountants and the conceptual framework for applying those principles which are set out in Parts A to C. Consequently, it is not sufficient for a professional accountant merely to comply with the additional ethical requirements under this Part; rather, the entire Code should be applied to the particular circumstances faced.

400.3 The sections under this Part originate from Professional Ethics Statements that were in existence prior to the issuance of the Code. They have not yet been conformed to all the requirements under Parts A to C which are adopted from the IESBA Code of Ethics for Professional Accountants. The Institute plans to review and update where necessary all the sections under this Part. The references to the previous Professional Ethics Statements are inserted in the relevant sections for easy reference.

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

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

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

SECTION 410

Unlawful Acts or Defaults by Clients of Members

This section should be read in conjunction with Section 140 "Confidentiality" and Section 225 "Responding to Non-Compliance with Laws and Regulations".

Occasions sometimes arise where a member, in carrying out his professional duties, acquires knowledge indicating that a client or an officer or employee of the client may have been guilty of some default or unlawful act. This may put him in a difficult situation of conflicting duties, aggravated sometimes by allegations that he himself is implicated in some way in those unlawful acts, or has some legal responsibility arising from those acts. Section 225 of the Code sets out the response framework for members in practice when members encounter or are made aware of suspected or actual non-compliance with laws and regulations in the course of providing professional services to clients. This section gives additional guidance to members concerning certain areas of difficulty, which involve both professional conduct and legal considerations. However, it is for general guidance only and in any particular case reference should also be made to any relevant legislation. Although various examples are given of the duties of members, they are examples only.

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

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

General Principles

Introduction

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 Section 225 of the Code sets out the response framework for members in practice to respond to suspected or actual non-compliance with laws and regulations committed by clients that have a direct effect on the client's financial statements or the operation of the client's business. This section provides additional local guidance to assist members in responding to situations when, in one way or another, their clients or officers or employees of their clients come under suspicion by the authorities (whether justified or not) of having committed some criminal offences, or members themselves have information that their clients have in one way or another become so implicated. The guidance given in the Guidelines is not intended to be exhaustive. There will arise from time to time situations of conflicting duties not covered by these Guidelines. Members should therefore use their own judgement in all cases and would be well advised to seek legal or other professional advice if in doubt.

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 unless the response framework set out in section 225 of the Code prescribes otherwise. Accordingly, the duty of confidentiality is not absolute. Where, for example, members acquire information in the course of an audit showing that actual or suspected defaults and unlawful acts have taken place, members may be duty-bound to make such disclosures and statements in their reports as would ensure that their functions and duties as auditors are properly discharged. Likewise members may have duties to make reports as auditors under the Banking Ordinance 1986 or to make disclosures to the relevant authorities under the Drug Trafficking (Recovery of Proceeds) Ordinance both of which require the disclosure of confidential information. Even if there is no law or regulation that requires members to disclose the defaults and unlawful acts, members should follow the response framework set out in section 225 of the Code and determine whether further action is needed, which may include disclosing the matter to an appropriate authority.

Relations Between a Member and His Client

Disclosure of Information by His Client to a Member

410.4 Where a member is engaged to prepare or audit accounts of a client or to deal with taxation or any other work relating to that client he should always make it clear to the client that he can only do so on the basis of full disclosure of all information relevant to the work in question. If the client will not agree, the member should not act for him.

410.5 If the client fails to provide such information or explanation as the member may require, the member has a clear professional obligation to indicate this fact in any report and may consider that he can no longer act. Under section 408 of the Companies Ordinance the auditor commits an offence if he knowingly or recklessly cause certain statements required by section 407(2)(b) and (3) of the Companies Ordinance to be omitted from the auditor's report. Section 407(2)(b) and (3) contain requirements on auditor's report when the auditor cannot obtain adequate information or explanation that are necessary and material for the purpose of the audit or when the financial statements are not in agreement with the accounting records in any material respect.

410.6 Under section 413 of the Companies Ordinance a person commits an offence if:

(a) the person makes a statement to an auditor of a company that conveys or purports to convey any information or explanation that the auditor requires, or is entitled to require, under section 412(2) or (4) of the Companies Ordinance;

(b) the statement is misleading, false or deceptive in a material particular; and

(c) the person knows that, or is reckless as to whether or not, the statement is misleading, false or deceptive in a material particular.

410.7 A member may, in the course of acting for one client, acquire information which he is aware discredits the information supplied to the member by a second client. In such a case the member may not reveal to the second client any information obtained as a result of his dealings with the first client. To do so without permission would be a breach of the duty of confidentially owed to the first client. In practice it will probably not be possible to obtain the first client’s permission to disclose information to the second client without a breach of confidentiality in respect of the second client’s affairs. The member must first do his best to make sure that the information that he has acquired is valid. Thereafter, the member should use every endeavour to obtain from within the records of the second client evidence to substantiate independently the information acquired from the first client. In the absence of any such evidence the member should, in appropriate cases, consider seeking the second client’s consent to obtaining direct confirmation of the information concerned. If the member is seeking confirmation in connection with his work as auditor of the second client and consent is refused he should consider qualifying his report or resigning, and, where relevant, making an appropriate statement under sections 417 and 424 of the Companies Ordinance without revealing the name of the first client. In other cases where consent is refused the member should consider ceasing to act.

Disclosure of Defaults or Unlawful Acts

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

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 is by no means absolute. There will be circumstances where a member is *required by law or statute* to disclose to others knowledge of defaults or criminal acts acquired in the course of such confidential relationship. Even if there is no law or regulation that requires the member to disclose suspected or actual non-compliance matters, members should follow the response framework set out in section 225 of the Code to respond to such non-compliance situations and determine whether further action is needed, which may include disclosing the matter to an appropriate authority.

Obligation to Disclose

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 Independent Commission Against Corruption ('ICAC') or other authority in the course of making enquiries concerning the affairs of a client or former client, the member should act with caution. He should first ascertain whether or not the person requesting information has a statutory right to demand it. Generally speaking, a member will not be acting contrary to law if he refuses to impart information to persons who have no statutory right to demand it; on the other hand, he might well be acting in breach of his duty of confidence to his client if he volunteers the information. It is advisable for members to seek legal advice to clarify the legal aspects of their positions if in doubt. Nevertheless, if a member has encountered or is aware of any suspected or actual non-compliance with laws and regulations in the course of providing professional services to his client that is related to the enquiry made by the authority, he should follow the response framework set out in section 225 of the Code and determine whether further action is needed, which may include disclosing the matter to an appropriate authority.

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.

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.

Disclosure for the Protection of the Member's Own Interest

410.17 [Not used]

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

(a) where it might enable the member to defend himself against a criminal charge or to clear himself of suspicion; or

(b) to resist an action for negligence brought against him by his client or some third person; or

(c) to enable the member to defend himself against disciplinary proceedings or criticism of him which is the subject of enquiry under the disciplinary rules of the Hong Kong Institute of Certified Public Accountants (the "Institute"); or

(d) to enable the member to sue for his fees.

Members' Own Relations with Authorities

Criminal Offences

410.19 A member himself commits a criminal offence:

(a) if he incites a client or anyone else to commit a criminal offence; or

(b) if he helps or encourages a client or anyone else in the planning or execution of a criminal offence; or

(c) if he agrees with a client or anyone else to pervert or obstruct the course of justice by concealing, destroying or fabricating evidence or by misleading the police by statements which he knows to be untrue.

410.20 Further, section 90 of the Criminal Procedure Ordinance makes it a criminal offence for anyone to do any act with intent to impede the apprehension or prosecution of another person, knowing that the other person has committed a serious offence.

410.21 Section 91 of the Criminal Procedure Ordinance makes it a criminal offence for anyone, knowing that a serious offence has been committed by another person, and knowing (or believing) that he has information that might be of material assistance in securing the prosecution or conviction of that person, accepts any consideration for not disclosing such information.

410.22 With regard to paragraphs 410.20 and 410.21 above, offences under the Inland Revenue Ordinance involving the evasion (or attempted evasion) of tax assessable under the Ordinance may constitute a "serious offence" as referred to in those two paragraphs above.

Taxation Matters

Introduction

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

410.24 The making of false statements (whether written or not) relating to tax with intent to defraud the Revenue or delivery of false documents with that intent are likewise criminal offences.

410.25 Tax avoidance is not an offence and should be distinguished from evasion. Avoidance consists of the arrangement of a taxpayer's affairs within the law so as to minimise the incidence of tax. In advising on methods of minimizing tax, members must obviously have regard to the dominant objectives of the client's transactions, particularly having regard to the provisions of sections 61 and 61A of the Inland Revenue Ordinance.

Penalty Proceedings and Mitigation

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

Property Tax, Salaries Tax, Profits Tax and Interest Tax

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

Taxation Frauds and Negligence Involving Accounts

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

410.28 The attention of members is drawn to subsection (5) of section 51 of the Inland Revenue Ordinance which provides that any returns or statements submitted by or on behalf of any person shall be deemed to have been submitted by him or by his authority unless he proves the contrary. In view of this provision, and in order to minimise the risk of misunderstanding between the client and the accountant, members are recommended to ensure that they are acting under an appropriate authority when submitting accounts to the Inland Revenue Department in connection with the ascertainment of a client's liability to property tax, profits tax or interest tax and to take steps to ensure that the client has signed or otherwise approved the accounts.

Past accounts later found to be defective

410.29 A member's duty of confidence to his client can be qualified by the client's own conduct. If a client has withheld information from or otherwise deceived a member, with the result that accounts prepared or reported upon by him or returns or computations based thereon were defective, and the member has submitted or is aware that the client has submitted those accounts or documents to the Inland Revenue Department, it would be improper for the member to allow the Inland Revenue Department to continue to rely upon them. He should advise his client to make a complete disclosure to the Inland Revenue Department. (For the circumstances in which disclosure may be justified see paragraphs 410.8 to 410.18 above).

410.30 Having advised his client to make such disclosure without delay, the member should, for his own protection, ensure that a record of his advice to his client is kept, so as to rebut any possible charge of conspiracy with or of aiding and abetting his client under section 80(4) or of assisting his client to evade tax under section 82(1) of the Inland Revenue Ordinance.

410.31 If the client refuses to act in accordance with the member's advice to make an immediate disclosure, the member should inform his client that he can no longer act for him in tax matters and that it will be necessary for the member to inform the Inland Revenue Department that, since he prepared or reported upon the accounts concerned or the returns or computations based thereon, he has acquired information which indicates that those accounts or documents cannot be relied upon and that he has ceased to act for the client in tax matters. The member should then so inform the Inland Revenue Department. Under sections 51(4) and 51B of the Inland Revenue Ordinance, the Inland Revenue Department may require members to furnish relevant information as may be required, and may obtain search warrants for the purpose of obtaining such information. Should such action be taken by the Inland Revenue Department, the member would be under no obligation to obtain the client's consent before releasing such information. Even if the Inland Revenue Department does not invoke section 51(4) and 51B of the Inland Revenue Ordinance, members should follow the response framework set out in section 225 of the Code and determine whether further action is needed, which may include disclosing the matter to an appropriate authority.

Accounts currently being prepared or audited

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, there is no further legal duty rests on the member towards the Inland Revenue Department unless the Inland Revenue Department invokes section 51(4) or 51B of the Inland Revenue Ordinance. However, members are reminded that under section 225.30 of the Code, withdrawing from an engagement or a professional relationship in response to non-compliance with laws and regulations would not discharge the members' professional duty under the Code as withdrawing from an engagement or a professional relationship is not a substitute for taking other appropriate actions, e.g. disclosing the matter to an appropriate authority.

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 responsibility towards the Inland Revenue Department. In the event of his receiving any enquiry from the Inland Revenue Department he should normally do no more than state that he is not dealing with taxation matters and that all enquiries should be addressed to the client. If the enquiry indicates that accounts bearing the member's name have been submitted he should normally state that he cannot add to his report thereon. The position is the same whether or not the member has acted for the client in taxation matters in previous years.

(c) on the other hand, if the client requests the member to undertake the taxation work he should always make it clear to the client that he can do so only on the basis of full

disclosure of all relevant information. If the client will not agree, the member should state that he cannot act for him in taxation matters and in that case the position regarding any enquiries the member may receive from the Inland Revenue Department is the same as in b above.

In any cases, the Inland Revenue Department may invoke section 51(4) or 51B of the Inland Revenue Ordinance to obtain relevant information from members. Members also have a professional duty to follow the response framework set out in section 225 of the Code and determine whether further action is needed, which may include disclosing the matter to an appropriate authority.

410.35 Where the member has not been requested, or has declined, to act in taxation matters (items (b) and (c) of the preceding paragraph), he could lawfully continue in the future to act as accountant or auditor, including appropriate qualifications when necessary in his reports on the accounts, but not taking any part in taxation matters. In the circumstances envisaged, however, it seems likely that either the member or the client would not wish to continue the professional association between them.

Past accounts of a new client

410.36 A member who is engaged in preparing or auditing accounts for a new client may acquire knowledge indicating that accounts submitted to the Inland Revenue Department for previous years were defective. In these circumstances:

(a) the member should advise his client to make a complete disclosure to the Inland Revenue Department;

(b) the member has no responsibility for the past accounts but if the nature of the defects in them is such as to affect the correctness of the accounts which the member is engaged in preparing or auditing he should inform his client that an appropriate adjustment will need to be made and shown separately in those accounts; and if the client refuses to agree to such an adjustment the member should include appropriate qualifications in his report on the accounts. Paragraphs 410.33 to 410.35 would then apply.

Taxation Frauds and Negligence not Involving Accounts

410.37 Paragraphs 410.28 to 410.36 above relate to taxation frauds and negligence through the medium of defective accounts. A member may, however, acquire knowledge indicating that a client has been guilty of taxation frauds or negligence by means which do not affect the client's accounts, for example, the submission of incorrect returns of private income. The member should advise his client to make a complete disclosure to the Inland Revenue Department. If the client refuses to do so, the member's position will depend upon whether or not the matter is within the scope of the duties he has undertaken for the client:

(a) if it relates to taxation matters on which the member has not acted for the client (for example, omission of private income where the member has dealt only with the tax computations of business profits and not with the client's tax returns), the member has no legal duty to make any disclosure to the Inland Revenue Department. He could lawfully continue to act for the client as hitherto. He may prefer to terminate the association.

(b) if it relates to taxation matters on which the member has acted for the client, then the member should inform the client that he can no longer act for him and that it will be necessary for the member to inform the Inland Revenue Department that he must dissociate himself from the returns (or other information involved) for the years in question and that he has ceased to act for the client on taxation matters. The member should then so inform the Inland Revenue Department.

In the case of either a or b above, the Inland Revenue Department may invoke section 51(4) or 51B of the Inland Revenue Ordinance to obtain such further details as may be relevant. Members also have the professional duty to follow the response framework in section 225

of the Code and determine whether further action is needed, which may include disclosing such taxation frauds and negligence to an appropriate authority.

General Professional Duty to Give Guidance

410.38 A member should regard himself as having a professional obligation to urge upon a client, in the client's own interests, the importance of making a full disclosure and authorising the member to proceed, where necessary, with "back duty" negotiations.

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.

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. Where a member has taken over the practice of another accountant, he may receive a request from the Inland Revenue Department for his co-operation by way of providing information relating to his clients, the object being to enable the Department to make a general review to decide whether there are any clients whose affairs appear to need further investigation. The member should not normally disclose information without client's consent unless he is compelled by law or he determines that such disclosure is needed in the public interest according to section 225 of the Code.

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 unless such disclosure is required by law or regulation or when the member determines that it is needed in the public interest in accordance with section 225 of the Code. The following paragraphs provide guidance about disclosure of the working papers listed in paragraph 410.46:

(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. Members should normally not produce such working papers to the Inland Revenue Department without client's consent unless it is required by law or regulation or when members determines that it is needed in the public interest in accordance with section 225 of the Code. Members are advised to seek legal advice if in doubt as to his rights and duty to disclose.

Other Taxes and Duties

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, and whether such disclosure is needed in the public interest in accordance with section 225 of the Code.

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 Inland Revenue Department or committing other offences, references in this section to the "client" should be regarded in the first instance as referring to the directors of the company: for example, where it is necessary for the member to advise a client to make a full disclosure to the Inland Revenue Department the advice should be given to the directors.

Qualifications in the Auditor's Report

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

410.51 Members are advised not to attempt to avoid the awkward responsibility of qualifying the report on the accounts by refusing to report and by resigning. A member has a contractual duty to the shareholders to report to them on the accounts, and should make every effort to discharge this duty. The member's proper course of action is to report upon the accounts. He should then consider whether to accept reappointment at the next General Meeting when his term of office expires. In any case, the member will not be able to avoid bringing to the attention of shareholders circumstances which may indicate that offences have been committed by resigning his office. Section 424 of the Companies Ordinance requires him to include in his notice of resignation a statement of any circumstances connected with his resignation which he considers should be brought to the notice of members or creditors of the company, or else a statement to the effect that there are no such circumstances. His resignation will be treated as ineffective unless he complies with this obligation. Members should refer to Section 440 "Changes in a Professional Appointment" for further guidance.

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

Transmission of Report to Shareholders

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

shareholders, it may be necessary for him to take such steps as are practicable to communicate the contents of his report direct to the shareholders. As soon as the possibility of making such a communication arises, therefore, he should seek legal advice about his duty to the shareholders in the particular circumstances of the case, as to the method of any communication his duty requires and as to the terms in which the communication should be made.

.

Past Accounts

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

(a) The Inland Revenue Department. The auditor should follow the procedure set out in paragraphs 410.29 to 410.31 above whether it is the directors or the directors and the shareholders who refuse to comply with the auditor's advice and whether or not the auditor is removed from office by means of a general meeting specially called for that purpose.

(b) Shareholders. The auditor should consider whether it is necessary that the shareholders be informed of the falsity of the past accounts. If it is necessary, he should do so either by exercising his right to speak at a general meeting on any part of the business which concerns him or by adjusting the next accounts or, if he feels that matters cannot properly be left for so long, by requesting the directors to issue a suitable statement to the shareholders. If they refuse to do so, or do not do so to his satisfaction, the auditor may have to take such steps as are practicable to notify the shareholders himself. As soon as the possibility of making such a communication arises, therefore, he should seek legal advice about his duty to the shareholders in the particular circumstances of the case, as to the method of any communications his duty requires and as to the terms in which the communication should be made.

(c) Third parties. The auditor ought not to allow anyone to continue to rely upon accounts on which he has reported, but now finds to be false, if there is any possibility of the third party acting to his detriment through reliance on the false accounts. An auditor might be held to be guilty of fraud (though the point is not covered by any authority) or held to be civilly liable in negligence (see the ICAEW statement "Accountants' Liability to Third Parties - The Hedley Byrne Decision") if he knew that the accounts had been submitted to a third party as an inducement to the third party to act thereon and he failed to inform the third party on discovering the falsity of the accounts before the third party had acted to his detriment. And in the case of a listed company an auditor should follow the response framework set out in section 225 of the Code and determine whether further action is needed, which may include informing the relevant Stock Exchanges of what he had discovered. It is advised that, before making any such communication, he should seek legal advice about his duty and rights in the particular circumstances of the case, as to the method of any communication he decides to make and as to the terms in which the communication should be made.

Removal of the Auditor

410.55 The distinction between the directors and the shareholders will sometimes have little or no relevance, either because the directors hold a controlling interest or because all the shareholders are directors. When in these circumstances the directors fail to comply with the auditor's advice they are likely to wish to prevent the auditor from completing his audit and making a report containing qualifications. They could achieve this by calling a general meeting at which the sole business would be the removal of the auditor, no accounts being placed before the meeting. If this procedure is followed, the auditor may wish to exercise his right under section 411 of the Companies Ordinance to attend the meeting and be heard. The auditor may also consider exercising the rights under section 422(3) of the Companies Ordinance by giving the company a statement that sets out in reasonable length the circumstances surrounding the proposed removal and may request the company to comply with the requirements specified in section 422(5) of the Companies Ordinance in relation to the statement. If he has been acting for the company in relation to taxation matters, and he receives any enquiries from the Inland Revenue Department he should follow the guidance in paragraphs 410.23 to 410.48 when responding to the Inland Revenue Department.

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. Under this circumstance, the auditor's appropriate course is to make available to the liquidator all relevant information, leaving with the liquidator the responsibility of deciding whether under section 277 of Companies (Winding Up and Miscellaneous Provisions) Ordinance the liquidator has a duty to make a report to the Secretary for Justice. If such a report is made by the liquidator then the auditor is, by subsection (4), one of the persons having a statutory duty to give assistance to the Secretary for Justice, so that in these circumstances his duty of confidence is overridden by the statutory provisions. However, if the auditor has encountered or is aware of any suspected or actual non-compliance with laws and regulations of the clients which is related to the enquiry made by the police, the auditor should follow the response framework set out in section 225 of the Code and determine whether further action is needed, which may include disclosing the matter to the police, without referring to the liquidator.

410.58 The appointment of a member to the office of liquidator or receiver of a company does not give rise to a professional, client relationship vis-a-vis the company and a member would not therefore in such circumstances normally be under any duty of confidence towards the company. If, however, the member is already the auditor of the company at the time of his appointment as liquidator *in a members voluntary winding up,* he is clearly under a duty of confidence in respect of matters which came to his knowledge while as auditor and the normal considerations would apply except to the extent that as liquidator he is under a statutory duty to disclose or report certain matters. Though a receiver appointed under the powers contained in an instrument is normally appointed as agent of the company, a receiver of the property of a company, whether appointed by the Court or under hand, is not a representative of the company in the way in which a liquidator is. Therefore an auditor of the company should continue to regard the company or its liquidator as his client, the appointment of a receiver notwithstanding.

Companies under Investigation

410.59 In respect of the inspector appointed to investigate a company's affairs, under section 846 of the Companies Ordinance, the auditor is one of the persons who has a statutory duty to:

(a) produce any record or document that is or may be relevant to the investigation and is in the person's custody or power;

(b) take all reasonable steps to preserve the record or document before it is produced to the inspector;

(c) attend before the inspector at the time and place specified in the notice, and answer any question, whether on oath or otherwise, relating to any matter under investigation that the inspector may raise with the person;

(d) answer any question relating to any matter under investigation;

(e) give the inspector all other assistance in connection with the investigation that the person is reasonably able to give.

Where these provisions apply the auditor’s duty of confidence is overridden by his statutory duty.

410.59A Under section 848 of the Companies Ordinance the inspector may make copies, or otherwise record the details, of the record or document; and by notice in writing, require the person to provide any information or explanation in respect of the record or document. The inspector may also, by notice in writing, further require the person to verify, within the time specified in that further requirement, the answer, information or explanation by a statutory declaration. If a person does not give any answer or provide any information or explanation for the answer, information or explanation is not within the person's knowledge or in the person's possession, the inspector may, by notice in writing, further require the person to verify, within the time specified in that further requirement, that reason and fact by a statutory declaration.

410.59B In case the inspector considers it necessary for the purpose of the investigation, under section 849 of the Companies Ordinance the inspector may also exercise any or all of the powers under section 846 and 848 of the Companies Ordinance as described in the paragraphs 410.59 and 410.59A in relation to an associated body corporate of the company.

Special Points In Connection with Sole Traders and Partnerships

410.60 For sole traders and partnerships a practising member may have to work from incomplete records and within limits laid down by his client. Such clients are not subject to statutory requirements similar to those relating to the accounts and audit of companies incorporated under the Companies Ordinance. Such a company has statutory obligations in regard to its accounting records and the auditor has a statutory duty to report when in his opinion those obligations have not been complied with: moreover such a company is required to have its accounts audited and it cannot limit the duties and powers of the auditor or the responsibility he undertakes for satisfying himself that the accounts show a true and fair view except as provided for the private companies and companies limited by guarantee falling within the reporting exemption under section 359 of the Companies Ordinance. As such statutory requirements are not present in the case of sole traders and partnerships, it is important that anyone who sees the accounts should be made aware, by the member’s report, of the significance of the association of his name with the accounts.

410.61 Where a member is acting for a client in taxation matters he may receive from the Inland Revenue Department questions designed to ascertain whether all receipts have been properly accounted for, or whether disallowable expenditure is included in amounts charged in the accounts, or whether stock has been valued on proper and consistent principles. A member should not undertake responsibility for replies to such questions unless he is satisfied from his examination of the books and records that all relevant information is

available to him. Where he is not so satisfied his proper course is to obtain answers from his client and pass them on as such to the Inland Revenue Department.

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, follow the response framework set out in section 225 of the Code.

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 section 440 "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 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) the legal position of the retiring member depends not upon whether the prospective successor has received the client's permission to communicate with the retiring members but upon whether the retiring member has been authorised by the client to discuss the client's affairs with the prospective successor. The retiring member could obtain this authorisation either by having made it a term of his contract with his client that he should be entitled to comply with the Code of Ethics issued by the Institute regarding these communications or by informing his client when the prospective successor communicates with him and getting express permission to tell the prospective successor the reasons for his retirement. If he has this authorisation then provided he says what he honestly believes to be true he can state the reasons for his retirement without any fear of an action for either breach of contract or defamation. If he does not have this authorisation the Council is advised that he would nevertheless have a strong measure of protection against an action for defamation in that his communication would be the subject of qualified privilege, which means that he would not be liable to pay damages for defamatory statements, even though untrue, if they were made without malice: and provided he stated only what he sincerely believed to be true the chances of his being held malicious are remote. Moreover although in making a communication without authorisation a retiring member might technically be in breach of contract and although there could be circumstances in which the resulting damages were substantial, the likelihood of an action being brought against him is small and in most cases the damages awarded in such an action would be nominal;

(e) where a member, in the course of an audit of financial statements, has unconfirmed suspicion or actual knowledge that the audit client has defrauded the Inland Revenue Department or been guilty of some other unlawful act or default and as a result, has withdrawn from the professional relationship with the client, he should provide all such

facts and other information to a prospective successor who communicates with him without the need to obtain client's consent. (See paragraph 225.31 of the Code);

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

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, except that section 410.80(e) above does not apply to non-audit engagement.

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, ICAC or other authority by giving information about his client's affairs for the purposes of enquiries leading towards a prosecution of the client for an offence other than treason. If he is requested to give information he should comply if the person requesting the information has a statutory right to demand it. In any other cases, the member should follow the response framework set out in section 225 of the Code and determine whether further action is needed, which may include disclosing the information to an appropriate authority.

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

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

SECTION 411

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

This section should be read in conjunction with Section 140 "Confidentiality" and Section 360 "Responding to Non-Compliance with Laws and Regulations"

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 report the matter to non-executive directors and those charged with governance where these exist. Where this is not possible or fails to resolve the matter a member may wish to consider making a report to a third party. Members in business should refer to section 360 of the Code, which sets out the response framework when members encounter non-compliance with laws and regulations during the course of their work. Local guidance is provided below on reporting suspected defaults or unlawful acts to third parties outside the organisation for which the member works.

Part 2 - Relations between a Member and His Employer

Disclosure of Information by His Employer to a Member

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 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 determine that such disclosure is justified in the public interest (see section 360) or required for the protection of the member's own interest. Guidance on whether a member should disclose the matter to a third party is set out in the paragraphs below.

Obligation to Disclose

411.7 A member will be obliged to disclose information if compelled to do so by the process of law, for example under a court order. He may also be obliged to disclose information by statute, for example:

(a) a member may be obliged to disclose specified information to the liquidator, administrative receiver or administrator of his employer;

(b) he may be obliged to give information on oath to an inspector appointed by the Financial Secretary to investigate an alleged insider dealing offence;

(c) he may be obliged to disclose information to the ICAC under a statutory notice.

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

411.8 Under section 412 of the Companies Ordinance, the auditors of a company have a right of access to the company's accounting records and may require a person that is a related entity of the company (as defined in section 412(9) of the Companies Ordinance), or was a related entity of the company (as defined in section 412(9) of the Companies Ordinance) at the time to which the information or explanation relates, to provide the auditor with any information or explanation that the auditor reasonably requires for the performance of the duties as auditor of the company. Under section 413 of the Ordinance, a person commits an offence if:

(a) the person makes a statement to an auditor of a company that conveys or purports to convey any information or explanation that the auditor requires, or is entitled to require, under section 412(2) or (4) of the Ordinance;

(b) the statement is misleading, false or deceptive in a material particular; and

(c) the person knows that, or is reckless as to whether or not, the statement is misleading, false or deceptive in a material particular.

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

411.9 [Not used]

411.10 [Not used]

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 should follow the response framework in section 360 of the Code and determine whether further action is needed, which may include disclosing the matter to an appropriate authority.

Prosecution of an Employer or Former Employer

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 comply if the person requesting for information has such a legal right. In other cases, however, the member should follow the response framework in section 360 of the Code and determine whether further action is needed, which may include disclosing the matter to an appropriate authority.

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

Criminal Offences

411.16 A member himself commits a criminal offence:

(a) if he incites anyone to commit a criminal offence, whether or not his advice is accepted; or

(b) if he helps or encourages anyone in the planning or execution of a criminal offence which is committed; or

(c) if he agrees with anyone to pervert or obstruct the course of justice by concealing, destroying or fabricating evidence or by misleading the police by statements which he knows to be untrue; or

(d) if with a view to obtaining property or to obtaining for himself or another a pecuniary advantage he deceives any person, either by making a statement which he knows to be false or (in certain circumstances) by stating a "half-truth", i.e. making a statement but suppressing matters relevant to a proper appreciation of its significance.

411.17 Where a member knows or believes that an arrestable offence has been committed the member would himself commit a criminal offence if he were to do any act with the intention of impeding the arrest or prosecution of the person in question unless the member has lawful authority or reasonable excuse (section 90 of the Criminal Procedure Ordinance). The mere fact that he was the suspect's employee or fellow-employee would not be a reasonable excuse. An arrestable offence is one for which the sentence is fixed by law or "serious" offences for which a person not previously convicted can be sentenced to imprisonment.

411.18 A member would have to do some positive act to assist the suspect to escape arrest or prosecution for an arrestable offence in order to be convicted of the offence of impeding the arrest or prosecution of the suspect. If a member refuses to answer questions by the police about the suspect's affairs or refuses to produce documents relating to the suspect's affairs without the suspect's consent, the refusal would not be an act to impede the arrest or prosecution of the suspect.

411.19 Where a member knows or believes an arrestable offence has been committed and the member has information which might be of material assistance in the prosecution of the suspect for the offence, the member would be committing a criminal offence if he were to accept or agree to accept any consideration in return for not disclosing that information (section 91 of the Criminal Procedure Ordinance).

411.20 In these circumstances, the acceptance of reasonable remuneration for employment would not be an offence. However, if the remuneration were wholly or partly paid in consideration for the member not disclosing the information, the member would be committing an offence. The acceptance of unusually high remuneration might be used as evidence against a member.

411.21 A member must give full disclosure in his dealings with the Inland Revenue Department. Fraudulent evasion and attempted evasion of taxes are criminal offences. The making of false statements with intent to defraud the Revenue is also an offence. Some tax legislations (for example section 82 of the Inland Revenue Ordinance) create specific criminal offences, whilst breach of other provisions leads to the imposition of penalties.

Civil Liability

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

SECTION 420

Use of Designations and Institute's Logo

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

Use of Designations

Designations of Certified Public Accountant

Certified Public Accountant

420.1 Use of the designation "Certified Public Accountant (會計師)" or the initials "CPA" is governed by By-law 22 of the Professional Accountants By-laws (Cap. 50A) (By-laws).

420.2 With effect from the commencement of the Professional Accountants (Amendment) Ordinance 2004 on 8 September 2004, all current members on the Hong Kong Institute of Certified Public Accountants (the "Institute") membership register are deemed to be registered as certified public accountants under section 22(4) of the Professional Accountants Ordinance (Cap. 50) (PAO). They therefore acquire the designation "Certified Public Accountant (會計師)" and are entitled to use the initials "CPA" under By-law 22.

420.3 The designation "Certified Public Accountant (會計師)" or the initials "CPA" is used to describe a member's professional qualification. Under sections 42(1)(h), (ha), (i) and (ia) of the PAO the right to the use of the description "certified public accountant", the initials "CPA" or the characters "會計師" to carry on a business, trade or profession is reserved only for practice units as defined in section 2 of the PAO. Practice unit means a firm of Certified Public Accountants (Practising) practising accountancy, a Certified Public Accountant (Practising) practising on his own account or a Corporate Practice. Accordingly,

(a) a CPA not holding a practising certificate, who carries on a business, trade or profession whether by himself or through an entity, should not include the description "Certified Public Accountant" or the initials "CPA" or the characters "會計師" in his trade or business name or the trade or business name of the entity; and

(b) A CPA not holding a practising certificate, who registers his own name or the name of his entity as a trade or business name under the Business Registration Ordinance, should not include the description "Certified Public Accountant" or the initials "CPA" or the characters "會計師" in the trade or business name.

Fellow

420.4 Use of the designation "Fellow of the Hong Kong Institute of Certified Public Accountants (資深會計師)" or the initials "FCPA" is governed by By-law 22.

420.5 Under a Council Ruling, a Fellow of the Hong Kong Institute of Certified Public Accountants who holds a practising certificate may describe himself as a "Fellow of the Hong Kong Institute of Certified Public Accountants (Practising) (執業資深會計師)" and use the initials "FCPA (practising)".

Practice of Public Accountancy

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

420.7 Under By-law 25 however:

(a) a certified public accountant holding a practising certificate has the option of describing himself as "Certified Public Accountant (會計師)" or "Certified Public Accountant (Practising) (執業會計師)" and using the initials "CPA" or "CPA (practising)"; and

(b) a firm of Certified Public Accountants (Practising) or a Corporate Practice has the option of describing itself as "Certified Public Accountants" or "Certified Public Accountants (Practising)", or in Chinese "會計師事務所" or "會計師行".

Designation of Affiliate

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

Members in Overseas Countries

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

Use of Institute's Logo

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

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

SECTION 430

Ethics in Tax Practice

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

Fundamental Principles

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

Development of the Fundamental Principles

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

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

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

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

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

(a) contains a false or misleading statement;

(b) contains statements or information furnished by the client recklessly or without any real knowledge of whether they are true or false; or

(c) omits or obscures information required to be submitted and such omission or obscurity would mislead the Inland Revenue Department.

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

(a) inform the Inland Revenue Department that he has withdrawn his services.

(b) act according to paragraphs 225.39 – 225.56 of the Code, including consider whether disclosing the matter to the external auditor and / or the Inland Revenue Department.

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.

(b) If the client does not correct the error:

(i) the member should inform the client that he cannot act for him in connection with that return or other related information submitted to the authorities;

(ii) the member should consider whether continued association with the client in any capacity is consistent with his professional responsibilities;

(iii) and if the member concludes that he can continue with his professional relationships with the client, he should take all reasonable steps to assure himself that the error is not repeated in subsequent tax returns.

(c) If because of the error or omission, the member ceases to act for the client, in these circumstances, the member should advise the client of the position before informing the authorities of his having ceased to act.

(d) He should consider, under paragraphs 225.39 – 225.56 of the Code, whether disclosing the matter to the external auditor and / or the Inland Revenue Department is appropriate.

SECTION 431

Corporate Finance Advice

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

Introduction

431.1 This section applies to all members, and is issued by the Council not as a directive but to assist members to conduct themselves in a manner which the Council considers appropriate to the members of the Hong Kong Institute of Certified Public Accountants (the "Institute").

431.2 Its objective is to provide ethical guidance that will safeguard corporate finance clients by ensuring that they can rely on the objectivity and integrity of the advice given to them by members.

431.3 Failure to follow such guidance may constitute misconduct, and a member concerned may be at risk of having to justify his actions in answer to a complaint to the Institute. In addition, matters discussed in this section may have legal implications and a member who is in doubt as to his position should consider obtaining legal advice.

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” and Section 225 "Responding to Non-Compliance with Laws and Regulations").

431.25 Where in the course of corporate finance advice a firm prepares information for a client (for example a critique of the accounts of another company) it may be called upon to do so:

(a) in a document which is for the consumption of the client only;

(b) in order to assist the client to produce a document which will go out solely under the client’s name and authority, whether including quotations from the original document or not; or

(c) as part of a document which is to be published over the name of the firm.

431.26 Any statements or observations in a document prepared for a client must be such as, taken individually and as a whole, are justifiable on an objective examination of the available facts.

431.27 In the case of a document prepared solely for the client and its professional advisers, it should be a condition of the engagement that the document should not be disclosed to any third party without the firm’s express permission.

431.28 Any document whether for private or public use should be prepared in accordance with normal professional standards of integrity and objectivity and with a proper degree of care.

431.29 A firm is, in the absence of any indication to the contrary, entitled to assume that the published accounts of the company on which it is commenting have been prepared properly and in accordance with all relevant Accounting Standards. Where scope for alternative accounting treatment exists, and the accuracy of the comment or observation is dependent on an assumption as to the actual accounting treatment chosen, that assumption must be stated, together with any other assumptions material to the commentary. Where the firm is not in possession of sufficient information to warrant a clear opinion this should be declared in the document.

431.30 A firm must take responsibility for anything published under its name, and the published document should make clear the identity of the client for whom the firm is acting. To prevent misleading or out-of-context quotations, it should be a condition for the engagement that, if anything less than the full document is to be published, the text and its context should be expressly agreed with the firm.

431.31 A firm should ensure that public documents and circulars include prominently the name of the brokers, investment bank or other advisers responsible for promoting or underwriting the share or securities described in the document or circular, where different from that firm which has accepted the roles of sponsor, in order to make abundantly clear the roles undertaken by the various advisers.

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

431.32 A member who provides takeover services for clients is required to comply with the Codes which are expressly applied to professional advisers as well as to those engaged in the securities market. Members' attention is particularly drawn to Annex II - Guidance note: Compliance with the Hong Kong Takeovers and Share Repurchase Codes.

431.33 The Codes apply to what are described as "public companies in Hong Kong" and the persons to whom the Codes apply are stated to be as follows:

(a) directors of public companies;

(b) persons or groups of persons who seek to gain or consolidate control of public companies;

(c) their professional advisers; and

(d) those who are actively engaged in the securities market in all its aspects.

431.34 There is a definition of a "private company" under section 11 of the Companies Ordinance. It is a company which is not a company limited by guarantee and has three restrictions imposed by its articles:

(a) the right to transfer shares must be restricted;

(b) the maximum number of members, exclusive of employees and persons who were members while being employees of the company and who continue to be members after ceasing to be such employees, is 50; and

(c) the company is prohibited to invite the public to subscribe for any shares or debentures of the company.

431.35 Section 12 of the Companies Ordinance defines a "public company" as a company that is not a private company and not a company limited by guarantee. Section 94 of the Companies Ordinance stipulates that if a private company alters its articles so that they no longer include the three restrictions required to constitute it as a private company; on the date on which the alteration takes effect the company ceases to be a private company.

Requirement for Independent Advice

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

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

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

431.37 The onus is on the financial adviser to ensure that no conflict of interest exists which might affect, or be perceived to affect, the impartiality of the advice he gives. When there is any doubt, the financial adviser should disclose the conflict to the Takovers and Mergers Executive (the Executive). The adviser should not assume that the Executive is aware of the conflict or that the independence of the adviser is accepted by the Executive merely

because an announcement of the offer and appointment of the adviser is published. Consulting the Executive is always advisable to minimise the risk of any objection to the appointment after it has been publicly announced. When consulting the Executive, the financial adviser must disclose all relevant information which the Executive will require in order to render a fully informed decision.

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

Takeovers Subject to the Codes

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

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

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

Takeovers Not Subject to the Codes

431.40 Where a takeover is not subject to the Codes, and there is no substantial public interest involved, a firm may, subject to the implementation of appropriate safeguards (see paragraph 431.22 above), continue to advise both sides. However the firm should ensure that the interests of minority shareholders are protected, and in such cases should consider the desirability of one company having a wholly independent adviser.

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

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

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

Connected Transactions

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

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

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

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

431.44 It is not inappropriate however:

(a) for an auditor or reporting accountant to assist a client in raising capital;

(b) for a firm to conduct an acquisition search, which could identify another client as a target, provided the search is based solely on information which is not confidential to that client;

(c) for an auditor or reporting accountant to provide independent advice to a client or its professional advisers in connection with the issue or sale of shares or securities to the public; or

(d) for an auditor or reporting accountant to fulfil the responsibilities of a sponsor

Fees

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

431.46 In some circumstances, such as advising on a management buy-out, the raising of venture capital, acquisitions search or sales mandates, fees cannot realistically be charged save on a contingency basis; to require otherwise would, in certain cases, deprive potential clients of professional assistance, for example where the capacity of the client to pay is dependent upon the success or failure of the venture.

431.47 Where work is subject to a fee on a contingency, percentage or similar basis the capacity in which a member has worked and the basis of the remuneration should be made clear in any document prepared by the member in contemplation that a third party may rely on it.

Overseas Transactions

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

ANNEX I TO SECTION 431

Definition of Corporate Finance Activities

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

1. general corporate or general financial advice or assistance, in relation to the affairs of a company or any of its associates, to the company or officers thereof, including in particular advice or assistance as to borrowing profile, capital requirements and fund raising, investment and foreign exchange policies, dividend policies, share incentive schemes, investor relations, general meetings and proxy solicitation, board composition and management structure;

2. a takeover, acquisition, management buy-out, management buy-in or disposal of a business or a merger, de-merger, division, reconstruction or reorganisation:

   (a) by or on behalf of the client; or

(b) concerning any securities issued by any business carried on by or for the client;

3. the valuation or appraisal of any investment, asset, business or security;

4. (a) giving advice to any country or its central bank or other monetary authority or an international banking or financial institution whose members are countries (or their central banks or monetary authorities) with respect to financial matters including in particular the management, restructuring and securitisation of external debt and the promotion of inward investments; or

(b) any scheme for providing finance in connection with (a) above;

5. any kind of financing, refinancing or rescheduling or reorganisation of debt or any interest rate or currency swap or comparable operation related to any financing, refinancing or rescheduling or reorganisation of debt which has previously been effected or which is in contemplation;

6. the financing of a construction or other commercial or industrial project or the establishment of a new business or the expansion of a business;

7. the raising of borrowed moneys, whether by the issue of securitised debt instruments or otherwise, and including the formation and management of a syndicate to provide such finance;

8. (a) an offering or placement or other distribution of investments whether by the issuer or any other person or group of persons to the public or privately for subscription or purchase; or

(b) a listing of, or the admission of any securities to dealings on an investment exchange or a suspension or discontinuance of, or other matters arising from, any such listing or admission to dealings;

9. (a) an exchange, conversion, redemption, sale, purchase, re-issue or cancellation of any securities; or

(b) an alteration in the terms of any securities; or

(c) a reduction of capital or share premium account or a scheme of arrangement or similar operation involving or affecting any securities;

10. the underwriting of securities whether by the client himself or by a third party on behalf of the client or making arrangements with a view to or in connection with any such underwriting; and

11. provision of advice in relation to any transaction governed by the Listing Rules.

ANNEX II TO SECTION 431

Guidance Note

Compliance with the Hong Kong Takeovers and Share Repurchase Codes

(see paragraph 431.32 of Section 431)

1. A member who provides takeover services for clients is required to comply with the Hong Kong Takeovers and Share Repurchase Codes (the Codes), and with all rulings made and guidance issued under them by the Takeovers and Mergers Panel (the Panel).

2. Accordingly a member proposing to provide takeover services to a client should at the outset:

(a) explain that these responsibilities will apply; and

(b) include in the terms of the engagement recognition of the member's obligation to comply with the Codes including any steps which the member may be obliged to take

in performing those responsibilities. A specimen clause for the engagement letter is set out in paragraph 10 below.

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

3. As regards contractual relationships existing at the date of publication of this Guidance Note, members should seek to amend the relevant engagement letter to include such wording. Where this does not prove possible, members should inform clients of their intention to comply with the Codes. If the client objects to this, the member should carefully consider the reasons given for such objection and then consider whether it is appropriate to continue to act for the client. In such a situation it may be necessary for the member to take separate legal advice.

4. In this Guidance, “takeover services” means any professional services provided by a member to a client in connection with a transaction to which the Codes apply.

5. In the case of accountants, the kinds of activities most commonly relevant for this purpose include:

   (a) acting as financial adviser to one of the parties;

   (b) reporting on profit forecasts and/or valuations for the purposes of takeover documents;

   (c) conducting acquisition searches for clients, and introducing clients to other parties with a view to potential acquisitions; and

   (d) advising in relation to acquisitions and disposals of securities to which the Codes may apply.

6. Whilst the Codes do not define precisely the range of activities and transactions within its scope, paragraph 4 “Companies to which the Codes apply” of Chapter 1 “Introduction to the Codes” describes the companies which are subject to the Codes. In practice, those engaging in providing takeover services rarely experience difficulty in determining whether the Codes are or may be relevant to the activities proposed to be undertaken for any particular client.

7. A member who has provided or is providing takeover services to a client should:

   (a) supply to the Panel any information, books, documents or other records concerning the relevant transaction or arrangement which the Panel may properly require and which are in the possession or under the control of the member; and

   (b) otherwise render all such assistance as the member is reasonably able to give to the Panel,

   provided that in each case the relevant information, books, documents or other records were acquired by the member in the course of the member providing the relevant takeover services.

8. Except with the consent of the Panel, a member should not provide or continue to provide takeover services for any person if the Panel has stated that it considers that the facilities of the securities markets in the Hong Kong should be withheld from that person and has not subsequently indicated a change in this view.

9. If members have included in the engagement letter agreed with their client a provision to the effect of that recommended in paragraph 2(b) above, they will be able to discharge their responsibilities under paragraphs 7 and/or 8 above, without any breach of confidentiality or duty to the client. While members should include such a provision, it is recognised that, on occasion, compliance with such responsibilities may still involve a breach of confidentiality to a third party or a breach of some other duty owed to the client. In such circumstances members should consider obtaining legal advice.

10. The client agrees and acknowledges that where the services provided by the firm relate to a transaction within the scope of the Codes, the client and the firm will comply with the provisions of the Codes and the firm will observe Section 431 issued by the Institute relevant to such services or transactions. In particular, the client acknowledges that:

    (a) if the client or its advisers or agents fail to comply with the Codes then the firm may withdraw from acting for the client; and

    (b) the firm is obliged to supply to the Panel any information, books, documents or other records concerning the services or transaction which the Panel may properly require.

SECTION 440

Changes in a Professional Appointment

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

The Statement

Preamble

440.1 Where a change of auditor is contemplated, the nominated auditor should write to the existing auditor to obtain "professional clearance". This is an important procedure to be followed to protect the interest of the nominated auditor, such that he may be made aware of any unusual circumstances surrounding the proposed change of auditor which may be relevant in determining his acceptance of nomination.

440.2 The existing auditor should act promptly upon receipt of such written request from the nominated auditor. Where it is the wish of a client to change auditor, the existing auditor should not cause undue hindrance to such a change, and should co-operate with the client and the nominated auditor to facilitate the flow of information and an effective change over.

Audit Appointments

440.3 A member who is asked to accept nomination as auditor should, save where the company or organisation has not previously had an auditor:

(a) find out whether the change of auditor has been properly dealt with in accordance with the Companies Ordinance or other legislation; and

(b) request the prospective client's permission to communicate with the auditor last appointed.

440.4 If a member is aware that the change of auditor has not been properly dealt with in accordance with the Companies Ordinance or other legislation by the company or organisation, he should advise his prospective client of any remedial action.

440.5 A member should decline nomination if the prospective client:

(a) fails to properly deal with the change of auditor in accordance with the Companies Ordinance or other legislation; or

(b) refuses permission for him to communicate with the auditor last appointed.

440.6 On receipt of permission to communicate with the auditor last appointed, a member should request in writing of the latter if there are any unusual circumstances surrounding the proposed change which he should be aware of, so that he may determine whether he should accept nomination. An example of such written request is given in the Appendix.

440.7 A member receiving such written request should act expeditiously and:

(a) if there is no professional or other reason why the proposed nominee should not accept nomination, reply accordingly without delay; or

(b) if he considers it appropriate to discuss the client's affairs with the proposed nominee, request permission of the client to do so freely.[1] If this request is not granted the member should report that fact to the proposed nominee who should not accept nomination.

[1] Section 414 of the Companies Ordinance (Cap.622) aims to facilitate transitional arrangements in the event of any changes in the auditor of a company. The section provides that an outgoing auditor does not contravene any duty just because he gives "work-related information" to an incoming auditor. "Work-related information" means information of which the person became aware in the capacity as such auditor. Please refer to the section for details.

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

Other Appointments

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

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

Guidelines

General

440.11 Although the guidance which follows takes as its basis the replacement of an auditor of a company, that basis is adopted as but one example of a change in a professional appointment. It follows that the considerations arising on a change of auditor generally also apply, in appropriate fashion, when a member is invited to undertake advisory work of a recurring nature (including the provision of services such as, e.g. accountancy and taxation) in place of another accountant, except for paragraph 440.23 which applies only to audit engagement. They apply whether the client is a company or any other corporate body, an individual, a partnership or any other kind of association, and a member invited to accept nomination or appointment as auditor of a body other than a company should be guided by the same considerations as those indicated in relation to a company. In the case of an audit client they apply in respect of non-audit work as they do to audit work. The reasons for communication as set out in this guidance are equally applicable in all cases.

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 (See paragraph 440.23 for circumstance where client's consent is not needed).

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 If the existing auditor has withdrawn from the professional relationship pursuant to paragraphs 225.25 and 225.29 of the Code, he should, on request by the proposed new auditor, provide all facts and other information concerning the identified or suspected non-compliance with laws and regulations to the proposed new auditor without the need to obtain client's consent, unless prohibited by law or regulation. See paragraph 225.31 of the Code for further guidance.

440.24 Where there has been failure or refusal by the client to supply him with information properly required by him for the performance of his duties, the existing auditor should so inform the proposed new auditor.

440.25 It may be essential for the performance of his professional obligations defined in this guidance or (if the member subsequently accepts appointment) for the proper discharge of his duties as auditor, that the member should disclose information given to him by his predecessor. For example, disclosure to officers or employees of the client may be unavoidable if the matters brought to his attention by his predecessor are to be properly investigated. However, such disclosure should be no wider than is necessary for the performance of these obligations and duties. Unless the foregoing considerations apply, the member should treat in the strictest confidence any information given to him by an outgoing auditor. He should give due weight to the reply of that auditor and to any representations which the latter may inform him he intends to make to the shareholders. Resentment on the part of the existing auditor of the actions taken by those who propose a change or at the possible loss of an audit is not a valid argument against the change.

440.26 If the member does not receive within a reasonable time a reply to his communication to the existing auditor and he has no reason to believe that there are any unusual circumstances surrounding the proposed change, he should endeavour to get into touch with the existing auditor by some other means. If he is unable to do so, or is unable to obtain a satisfactory outcome in this way he should send a further letter, preferably by recorded delivery service, stating that unless he receives a reply within a specified time, he will assume that there are no matters of which he should be aware before deciding whether to accept.

440.27 [Not used]

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

Appointment of a Joint Auditor

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

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

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

Filling a Casual Vacancy

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

Business Acquired by a New Company

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

Unpaid Fees of Previous Auditor

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

Transfer of Books and Papers

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

Providing Information to a Successor

440.35 The new auditor will often need to ask his predecessor for information as to the client's affairs, lack of which might prejudice the client's interests. Such information should be promptly given and, unless there is good reason to the contrary, such as an unusual amount of work involved, no charge should be made.

440.36 The existing auditor is under no legal obligation to make any of his working papers available for review by the new auditor but he has an ethical obligation to respond to the new auditor's specific enquiries and, inter alia, should make available, in respect of those specific areas, working papers relating to matters of continuing accounting significance, including information which may assist the new auditor in determining consistent application of accounting principles.

Statutory Provisions

440.37 By statute, an outgoing auditor or one whose replacement is proposed, is entitled and may be obliged to communicate to members or creditors matters connected with his ceasing to hold office and which he considers should be brought to their notice. Nothing in this section affects the exercise of those statutory rights or duties. Paragraphs 38-42 contain a non-exhaustive summary of the relevant provisions.

440.38 For an auditor whose appointment is terminated either when the term of office expires (unless the auditor is appointed as auditor of the company for a term immediately following the term of office that expires or is deemed to be reappointed as auditor of the company for the next financial year) or when the auditor is removed from office by an ordinary resolution of the company passed at a general meeting, under section 425 of the Companies Ordinance, the auditor must, on the termination, give the company:

(a) if he considers that there are circumstances connected with the termination that should be brought to the attention of the company's members or creditors, a statement of those circumstances (i.e. statement of circumstances); or

(b) if he considers that there are no such circumstances, a statement to that effect.

440.39 When special notice is given by the company for a resolution for appointing an incoming auditor in place of the outgoing auditor, under section 422(2) of the Companies Ordinance, the outgoing auditor:

(a) may give the company a statement that sets out in reasonable length the circumstances surrounding the termination of the appointment as auditor (i.e. cessation statement);

(b) may request the company to state in every notice of the meeting given to the members that the statement has been made and to send a copy of the statement to every member to whom a notice of the meeting is or has been given, if the company receives the statement on a date that is more than 2 days before the last day on which notice may be given to call the general meeting;

(c) may request the company to ensure that the statement is read out at the meeting, if the company has not sent a copy of the statement to every member to whom a notice of the meeting is or has been given;

(d) is entitled:

- to be given every notice of, and every other item of communication, relating to the general meeting, that a member of the company is entitled to be given;
- to attend the general meeting; and
- to be heard at the general meeting on any part of the business of the meeting that concerns the person as auditor or former auditor of the company.

440.40 When special notice is given by the company to the auditor on an ordinary resolution for removing him from the office of auditor, under section 422(3) of the Companies Ordinance the outgoing auditor:

- may give the company a statement that sets out in reasonable length the circumstances surrounding the proposed removal (i.e. cessation statement);
- may request the company to state in every notice of the meeting given to the members that the statement has been made and to send a copy of the statement to every member to whom a notice of the meeting is or has been given, if the company receives the statement on a date that is more than 2 days before the last day on which notice may be given to call the general meeting;
- may request the company to ensure that the statement is read out at the meeting, if the company has not sent a copy of the statement to every member to whom a notice of the meeting is or has been given.

440.41 When a proposed written resolution is given by the company for appointing an incoming auditor in place of the outgoing auditor, under section 423(2) of the Companies Ordinance, the outgoing auditor:

- may give the company a statement that sets out in reasonable length the circumstances surrounding the proposed termination of the appointment as auditor (i.e. cessation statement); and
- may require the company to send a copy of the statement to every member at the same time when the written resolution is circulated under section 550 or 552.

440.42 For an auditor who resigns by giving the company a notice in writing under section 417(1): his term of office expires at the end of the day on which the notice is given to the company or at a later date as specified in the notice. By section 424 of the Companies Ordinance such auditor must, on the resignation, give the company:

- if he considers that there are circumstances connected with the resignation that should be brought to the attention of the company's members or creditors, a statement of those circumstances (i.e. statement of circumstances); or
- if he considers that there are no such circumstances, a statement to that effect.

By section 421 of the Companies Ordinance, if the notice of resignation is accompanied by a statement of circumstances, such auditor may require the directors to convene a general meeting for receiving and considering the explanation of the circumstances connected with the resignation that the auditor places before the meeting. If such general meeting is convened, under section 422(1) of the Companies Ordinance such auditor:

- may give the company a statement that sets out in reasonable length the circumstances surrounding the resignation (i.e. cessation statement);
- may request the company to state in every notice of the meeting given to the members that the cessation statement has been made and to send a copy of the cessation statement to every member to whom a notice of the meeting is or has been given, if the company receives the statement on a date that is more than 2 days before the last day on which notice may be given to call the general meeting;
- may request the company to ensure that the cessation statement is read out at the meeting, if the company has not sent a copy of the cessation statement to every member to whom a notice of the meeting is or has been given;
- is entitled to be given every notice of, and every other item of communication, relating to the general meeting, that a member of the company is entitled to be given;
- is entitled to attend the general meeting and to be heard at the general meeting on any part of the business of the meeting that concerns the person as auditor or former auditor of the company.

440.43 Section 410 of the Companies Ordinance gives an auditor qualified privilege for statements made in the course of performing duties as auditor of the company. In particular, in the absence of malice, an auditor is not liable for defamation in respect of any cessation statement or statement of circumstances connected with his or her cessation of office.

APPENDIX

AN EXAMPLE OF A "CLEARANCE LETTER"

Dear Sirs,

We have been nominated to act as auditors of ..... Limited.

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

Yours faithfully,

SECTION 441

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

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

441.1 The Stock Exchange of Hong Kong Limited (SEHK) and the Securities and Futures Commission (SFC) have raised concerns with the Hong Kong Institute of Certified Public Accountants concerning announcements made by listed issuers of the SEHK of the reasons for changes in auditors. In many cases, fee disputes are stated to be the reason for the change. Concern has been expressed that certain auditors have been relying on purported fee disputes to disguise the real reasons for the change. As a result, potentially significant and fundamental matters about the listed issuer may not be disclosed to investors and creditors and the market is not therefore being kept fully informed. It is important that the situation concerning the change of auditors should be disclosed in full to avoid the possibility of the market being misled.

441.2 The purpose of this section, which has been prepared in consultation with the SEHK and the SFC, is to establish a framework to enhance communication by auditors with a listed issuer where there is a change of auditors. The framework requires the outgoing auditors to prepare a letter to the audit committee and the board of directors setting out the circumstances leading to their resignation or termination.

441.3 This section deals with changes of auditors of a listed issuer including auditors who resign before the expiration of their term of office, decide not to seek re-election at the Annual General Meeting, are notified by the directors that they will not be nominated for re-appointment, or are removed during their term of office.

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

441.5 Under Rule 13.88 of the Main Board Listing Rule and Rule 17.100 of the GEM Listing Rule, a listed issuer must at each annual general meeting appoint an auditor to hold office from the conclusion of that meeting until the next annual general meeting. The issuer must not remove its auditor before the end of the auditor's term of office without first obtaining shareholders' approval at a general meeting. An issuer must send a circular proposing the removal of the auditor to shareholders with any written representations from the auditor, not less than 10 business days before general meeting. An issuer must allow the auditor to attend the general meeting and make written and/or verbal representations to shareholders at the general meeting. Under code provision E.1.2 in Appendix 14 of Main Board Listing Rule and Appendix 15 of GEM Listing Rule, an issuer's management should ensure the external auditor attend the annual general meeting to answer questions about the conduct of the audit, the preparation and content of the auditor's report, the accounting policies and auditor independence.

441.6 Auditors of Hong Kong incorporated listed issuers are reminded that sections 417 and 424 of the Companies Ordinance require an auditor who resigns from office before the expiry of its term must, if the resignation is to be effective, include in his resignation a statement of any circumstances connected with his resignation which he considers ought to be brought to the notice of members or creditors of the company, or a statement that there are no such circumstances. Under section 425(1) such requirements are also extended to an auditor who has been removed and a retiring auditor who has not been reappointed. However, auditors are to note that this section is not intended to provide guidance regarding the above requirements of the Companies Ordinance.

441.7 The terms "listed issuer", "incoming auditors" and "outgoing auditors" are used throughout this section and are defined as follows:

(a) "Listed issuer" means a company listed on the Main Board or Growth Enterprise Market (GEM) of the SEHK.

(b) "Incoming auditors" means the auditors or the auditors to be nominated for the current period who did not audit the preceding period's financial statements.

(c) "Outgoing auditors" means the auditors who were previously the auditors and have been or are to be replaced by any incoming auditors.

Duty to the Shareholders to Report on the Financial Statements

441.8 Auditors are reminded that once they are appointed, they have a duty to the shareholders to report to them on the financial statements, and should make every reasonable effort to discharge this duty. Auditors should not attempt to avoid the responsibility of reporting on the financial statements by resigning.

441.9 The auditors' proper course of action, once appointed, is to report on the financial statements. If they are considering resigning during their term of office they should discuss the contentious issues which may lead to their resignation with the audit committee and seek the audit committee's assistance to resolve the issues with management and to complete the audit. Having completed the audit, if they do not wish to be re-appointed, they should decline to stand for re-appointment when their term of office expires.

Communication with the Audit Committee and the Board of Directors

441.10 This section requires the outgoing auditors to prepare a letter to the audit committee and the board of directors of the listed issuer, whenever:

(a) the outgoing auditors resign or decline to stand for re-appointment (Resignation); or

(b) the listed issuer decides to propose to its shareholders that the outgoing auditors be removed from office during the auditors' term of office, or there is a proposal or intention not to re-appoint them on the expiry of their term of office (Termination).

441.11 The outgoing auditors' letter to the audit committee and the board of directors should set out the circumstances leading to their Resignation or Termination, hereafter referred to as "Letter of Resignation or Termination". The circumstances to be disclosed in the Letter of Resignation or Termination are all occurrences that, in the opinion of the outgoing auditors, affect the relationship between the listed issuer and the outgoing auditors.

441.12 Occurrences that affect the relationship between the listed issuer and the outgoing auditors include, but are not limited to, "disagreements" and/or "unresolved issues", as discussed below. The disagreements and unresolved issues to be disclosed will generally be those that occurred in connection with:

(a) the audit of the listed issuer's most recently completed financial year;

(b) any period subsequent to the most recently completed financial period for which an audit report has been issued up to the date of the Resignation or Termination.

441.13 Disagreements refer to any matter of audit scope, accounting principles or policies or financial statement disclosure that, if not resolved to the satisfaction of the outgoing auditors, would have resulted in a qualification in the audit report.

441.14 Disagreements include both those resolved to the outgoing auditors' satisfaction which affect the relationship between the listed issuer and the outgoing auditors, and those not resolved to the outgoing auditors' satisfaction. Disagreements should have occurred at the decision making level, i.e., between personnel of the listed issuer responsible for the finalization of its financial statements and personnel of the auditors responsible for authorizing the issuance of audit reports with respect to the listed issuer.

441.15 The term disagreement is to be interpreted broadly. It is not necessary for there to have been an argument for there to have been a disagreement, merely a difference of opinion. The term disagreement does not include initial differences of opinion, based on incomplete facts or preliminary information, that were later resolved to the outgoing auditors' satisfaction, provided that the listed issuer and the outgoing auditors do not continue to have a difference of opinion upon obtaining additional facts or information.

441.16 Unresolved issues refer to matters which come to the outgoing auditors' attention and which, in the outgoing auditors' opinion, materially impact on the financial statements or audit reports (or which could have a material impact on them), where the outgoing auditors have advised the listed issuer about the matter and:

(a) the outgoing auditors have been unable to fully explore the matter and reach a conclusion as to its implications prior to a Resignation or Termination;

(b) the matter was not resolved to the outgoing auditors' satisfaction prior to a Resignation or Termination; or

(c) the outgoing auditors are no longer willing to be associated with the financial statements prepared by management of the listed issuer in relation to circumstances described in HKSA 560 "Subsequent Events" when it becomes effective on "Facts which become known to the auditor after the financial statements have been issued" resulting in the withdrawal of an audit report.

441.17 The outgoing auditors should note that disclosing the circumstances leading to their Resignation or Termination in the Letter of Resignation or Termination is the appropriate method of discharging their responsibilities during a change in a professional appointment without having to be concerned with the professional duty of confidentiality owed to the listed issuer. In the event that the incoming auditors approach the outgoing auditors for professional clearance and ask whether the outgoing auditors are aware of any unusual circumstances surrounding the proposed change of auditors which may be relevant in determining their acceptance of nomination, as required by Section 440 "Changes in a Professional Appointment", the outgoing auditors can refer the incoming auditors to their Letter of Resignation or Termination.

The Incoming Auditors

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

441.19 If the listed issuer refuses to provide the incoming auditors with a copy of the Letter of Resignation or Termination and any correspondence referred to in the Letter of Resignation or Termination, the incoming auditors should decline to accept nomination.

Announcement Made by the Listed Issuer on the Change of Auditors

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

441.21 The outgoing auditors should note that the listed issuer is required to make an announcement pursuant to the Listing Rules setting out the reason(s) for the change of auditors and any other matters that need to be brought to the attention of holders of securities of the issuer (including, but not limited to, circumstances set out in the outgoing auditors' Letter of Resignation or Termination in relation to the change of auditors). In the Letter of Resignation or Termination, the outgoing auditors should remind the listed issuer of this obligation and should give their express consent to the letter being supplied to the SEHK.

441.22 The outgoing auditors should read and assess whether the circumstances as reported in their Letter of Resignation or Termination, which, in their opinion, need to be brought to the attention of the shareholders, are reflected in the announcement made by the listed issuer. In the event that the outgoing auditors notice that the circumstances leading to their Resignation or Termination as announced by the listed issuer are materially different from the circumstances as reported by them in their Letter of Resignation or Termination in respect of matters that need to be brought to the attention of the shareholders, they should write to the audit committee and board of directors of the listed issuer regarding those matters.

441.23 In practice, it is recommended that the listed issuer should agree with the outgoing auditors the details relating to the circumstances in the announcement before its issuance. This is to help avoid the situation described in paragraph 441.22 above. However, it should be noted that such an approach should not unduly delay the listed issuer's announcement of the change of auditors.

441.24 If the outgoing auditors write in accordance with paragraph 441.22 above and the listed issuer takes no adequate action in response, they should consider whether the market has been adequately informed as to the circumstances leading to their Resignation or Termination. If not, the outgoing auditors should consider whether these should be brought to the attention of the relevant regulatory authority.

441.25 Should the outgoing auditors decide it necessary to report those matters to the SFC, they will be subject to the protection of sections 380 and 381 of the Securities and Futures Ordinance. Sections 380 and 381 of the Securities and Futures Ordinance provide immunity to a person who is or was an auditor of a company which is listed, or any associated company of the company, who reports to the SFC matters which come to his attention that suggest that at any time since the formation of the listed company, its shareholders have not been given all the information with respect to its affairs that they might reasonably expect. The outgoing auditors are advised to consult their lawyers before communicating.

SECTION 450

Practice Promotion

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

Introduction

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

Part 1 deals with scope and responsibilities;

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

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

Part 4 sets out prohibited media.

Part 1 - Scope and Responsibilities

Scope

450.1 This section applies to:

(a) Certified Public Accountants (Practising), including member practices, their affiliates and, members who are employees of member practices; and

(b) members advertising themselves as professional accountants providing professional and other services, whether as individuals, partnerships or through other entities over which they exercise control.

450.2 For the purposes of this section, an affiliate of a Certified Public Accountants (Practising) is deemed to be any individual or entity over which the Certified Public Accountants (Practising) exercises control or significant influence, regardless of whether such control or significant influence results from direct or indirect ownership, common ownership or other arrangement.

450.3 The provisions of this section are applicable to all forms of practice promotion, including publicity sought by members for their services, achievements and products and any advertising thereof.

450.4 The principles set out in this section apply equally to all forms of communication by members, e.g. letterheads, invoices, name cards and via electronic media.

Responsibilities

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

450.6 Where members receive the benefits of promotional activities by third parties they are reminded that they are not permitted to do through others what they are prohibited from doing themselves by the Code of Ethics for Professional Accountants issued by the Hong Kong Institute of Certified Public Accountants (the "Institute").

450.7 Members are required to use their best endeavours to ensure that promotional activities in Hong Kong by connected or associated individuals or entities outside Hong Kong, comply with this section.

450.8 In the event of a complaint being received by the Institute relating to the promotion of professional services, members will be required to justify their position or actions.

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

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

450.10 Where publicity, advertising or other forms of practice promotion are carried out, such activities should:

(a) be aimed at informing the recipients or the public in an objective manner;

(b) conform to the basic principles of legality, decency, clarity, honesty and truthfulness; and

(c) not project an image which is inconsistent with that of a professional person bound to high ethical and technical standards.

450.11 In no circumstances should any promotional activities be conducted in such a way or to such an extent as to amount to harassment or coercion of prospective clients.

450.12 Activities which are expressly prohibited include those which:

(a) create false, deceptive or unjustified expectations of favourable results;

(b) imply the ability to influence any court, tribunal, regulatory agency or similar body or official;

(c) make unjustified claims to be an expert or specialist in a particular field;

(d) contain purported statements of fact which cannot be verified or which are misleading by reason of the context in which they appear;

(e) make disparaging references to or disparaging comparisons with the services of others;

(f) contain testimonials or endorsements other than where:

(i) the prior consent has been obtained from the giver of the testimonial or endorsement;

(ii) the giver of the testimonial or endorsement is clearly identified; and

(iii) the testimonial or endorsement has not been obtained for reward;

(g) contain any other representations that would be likely to cause a reasonable person to misunderstand or be deceived.

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

Part 3 - Principles Applicable to Advertising

450.14 This Part sets out additional principles which must be observed with regard to advertising or other forms of promotional material which are widely circulated or on public display (subject to the restrictions set out in Part 4).

450.15 An advertisement should be clearly identified as such.

450.16 Advertising and promotional material should not contain references to scale charges or amounts of fees for professional and other services, nor should members make comparisons between their fees and the fees of others. It is, however, permissible to make reference to a free initial consultation at which levels of fees will be discussed. This Part of the section refers to advertising and therefore does not preclude members from quoting fees or a range of fees in proposals where they have been requested to do so by a prospective client.

450.17 As the “Homepage” of a website of a member or member practice is considered analogous to a newspaper advertisement, it is not allowed to contain any references to scale charges or amounts of fees. However information on scale charges or amounts of fees contained in a separate file on the website which is linked to the “Homepage” is allowed as the user is required to act to gain access to such information by clicking the relevant “icon” on the “Homepage”.

450.18 Members should not make generalised claims as regards size or quality. A claim to be, for example, the “largest” or “fastest growing” member practice in any area or field of practice is likely to be misleading, as it is impossible to know whether such a claim refers to the number of partners or staff, the number of offices or the amount of fee income. A claim to be the “best” or the “leading” member practice is subjective and cannot be substantiated.

450.19 Signboards and other notices on public display should be maintained at all times to a high standard and consistent with the dignity of the profession. Notices in the nature of handbills, stickers, etc. are unacceptable.

Part 4 - Prohibited Media

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

450.21 The restrictions set out below do not apply to members standing as candidates for public office. Such members are, however, required to ensure that they are not using their election campaigns to advertise their professional services.

Direct Mailing

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

450.23 The general exceptions to the above prohibition on direct mailing are:

(a) direct mailing of material to clients, close associates and other practising members or upon receipt of an unsolicited request from the recipient;

(b) direct mailing of material in relation to seminars, provided that it is strictly relevant to the seminar in question and should not be capable of being construed as an advertisement for the general professional services of the member;

(c) a member may send a letter introducing his practice and its range of services to another professional adviser, such as a solicitor or banker, provided that it is made clear that this is not done with the aim of procuring the professional adviser itself as a client.

Cold Calling

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

Distribution of Leaflets, Promotional Gifts and Other Items

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

SECTION 460

Clients' Monies

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

The Statement

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

Guidelines

460.2 In this section, the term "clients' monies" includes all monies received by a practice to be held or disbursed by it on the instructions of the person from whom or on whose behalf they are received.

460.3 Clients' monies should under normal circumstances be paid within five working days into a separate bank account, which may be either a general account or an account in the name of a specific client but which shall in all cases include in its title the word "client". Any such bank account is referred to herein as "a client account". It is desirable for a member to open a general client account at the commencement of his practice.

460.4 Whenever a practice opens a client account appropriate notice of the nature of the account should be given in clear terms to the bank at which the account is to be opened. Legal advice has been received to the effect that if this is done no question will arise of set-off by the bank against the member's other accounts or of sequestration by a trustee in bankruptcy of a member of the amounts held in the client account for the benefit of the general creditors of the bankrupt member.

460.5 Where a practice receives a cheque or draft which includes both clients' monies and other monies he should cause the same to be credited to a client account. Once the monies have been received into such client account a practice may withdraw from that account such part of the sum received as can properly be transferred to the office account in accordance with the principles set out in paragraph 460.7 below.

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

460.7 Drawings on a client account may be made only:

(a) to meet payments due from a client to the practice for professional work done by the practice for that client provided that:

(i) a bill has been rendered; and

(ii) the client has been informed in writing, and has not disagreed within a reasonable period of time, that money held or received for him will be so applied;

(b) to cover disbursements made on a client's behalf;

(c) to, or on the instructions of, a client.

460.8 A practice must be careful to differentiate, both in its records and, where appropriate, in its use of client accounts, between monies held on behalf of a client in his personal capacity and those, within the knowledge of the practice, held on behalf of the same client as trustee for others. Save where the size of the fund does not, on grounds of expense, warrant it, a separate client account should be opened to receive the trust monies of each separate trust.

460.9 In no circumstances should a practice permit any payment to be made to or on behalf of a client from a client account, whether by transfer to office account of the practice or otherwise, which will result in a drawing on the relevant client account exceeding the balance held in that account on such client's behalf.

460.10 Interest on client account monies:

(a) In the absence of express agreement to the contrary any interest received on a client's monies may be retained by the practice.

(b) Variations to sub-paragraph (a) above should be agreed between members and their clients. Any such agreement might conveniently be recorded in the engagement letter, or in any subsequent correspondence.

(c) Where a practice receives monies of a client for retention and it is under instructions from the client that the monies be deposited at interest, the practice shall so deposit them in a designated client deposit account in respect of which notice shall have been given as provided in paragraph 460.4. It may be appropriate for a practice to charge a fee for this service. If monies belonging to more than one client are held in the same client bank account, any interest arising thereon should be apportioned as appropriate among the clients concerned.

460.11 Money held by a member as stakeholder should be regarded as clients' money and should be paid into a separate bank account maintained for the purpose or into a client bank account. The disposition of interest arising from such monies should be the subject of an agreement between the parties.

460.12 Every member in practice should at all times maintain records so as to show clearly the money he has received, held or paid on account of his clients, and the details of any other money dealt with by him through a client account, clearly distinguishing the money of each client from the money of any other client and from his own money.

PART E – SPECIALIZED AREAS OF PRACTICE

Pages

Section 500 Professional Ethics in Liquidation and Insolvency 185-204

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

	Paragraphs
Part 1 - General Application	
Introduction	500.1 – 500.2
Scope	500.3 – 500.4
Fundamental principles	500.5 – 500.7
Framework Approach	500.8 – 500.9
Identification of threats to the fundamental principles	500.10 – 500.19
Evaluation of threats	500.20 – 500.21
Possible safeguards	500.22
Part 2 - Specific Application	
Accepting or Not Accepting Appointments	500.23 – 500.33
Conflicts of interest	500.34 – 500.36
Practice mergers	500.37 – 500.38
Transparency	500.39 – 500.40
Professional competency and due care	500.41 – 500.44
Professional and Personal Relationships	500.45
Identifying relationships	500.46 – 500.48
Is the relationship significant to the conduct of the appointment?	500.49 – 500.53
Dealing with the Assets of an Entity	500.54 – 500.57
Obtaining Specialist Advice and Services	500.58 – 500.61
Fees and Other Types of Remuneration	500.62 – 500.64
Obtaining Appointments	500.65 – 500.71
Gifts and Hospitality	500.72 – 500.76
Record Keeping	500.77 – 500.78
Part 3 - The Application of the Framework to Specific Situations	
Introduction to specific situations	500.79 – 500.80
Category A Examples that do not relate to a previous or existing appointment	500.81 – 500.85
Category B Examples relating to previous or existing appointments	500.86 – 500.91
Definitions	500.92
Effective Date	500.93

Section 500

Professional Ethics in Liquidation and Insolvency

This section should be read in the context of the fundamental principles of professional ethics for professional accountants and the conceptual framework for applying those principles which are set out in Part A of the Code of Ethics for Professional Accountants ("the Code").

Part 1 – General Application

Introduction

500.1 This section of the Code is intended to assist an insolvency practitioner meets the standards of conduct and ethics expected of him when undertaking or preparing to undertake liquidation and insolvency appointments. It should be noted that this section does not purport to cover the requirements that are imposed by authorities in other jurisdictions. It is also not intended to detract from any responsibilities which may be imposed by law or regulations. The headings in this section are intended to facilitate its presentation only and do not in any way affect the interpretation or meaning of its contents.

500.2 For avoidance of doubt, the use of the word “shall” in this section imposes a requirement on the insolvency practitioner or practice to comply with the specific provision in which “shall” has been used. Compliance is required unless an exception is permitted by this section.

Scope

500.3 This section of the Code is applicable to and governs the standards of conduct of all insolvency practitioners. An insolvency practitioner shall take steps to ensure that this section is applied in all professional work relating to liquidation and insolvency appointments, and to any professional work that may lead to such appointments. Although such an appointment will normally be of the insolvency practitioner personally rather than his practice, he shall ensure that the standards set out in this section are applied to all members of the insolvency team and his practice, where appropriate.

500.4 The appointments, to which this section of the Code refers, include but are not limited to the following appointments, whether in insolvent or solvent estates:

(a) liquidator, provisional liquidator, special manager, receiver (or receiver and manager), trustee in bankruptcy, provisional trustee in bankruptcy, nominee of an individual voluntary arrangement;

(b) administrator, manager, adjudicator or any other similar role, however described in respect of a scheme of arrangement between a company and its creditors;

(c) administrator under the Securities and Futures Ordinance (Cap. 571); and

(d) examiner in bankruptcy cases under the Official Receiver's Office tender scheme.

Fundamental Principles

500.5 An insolvency practitioner shall comply with the fundamental principles set out under paragraph 100.5 of this Code. The five fundamental principles are:

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

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

(c) *Professional Competence and Due Care* – to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional services based on current developments in practice, legislation and techniques, and act diligently and in accordance with applicable technical and professional standards.

(d) *Confidentiality* – to respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for the personal advantage of the insolvency practitioner or third parties.

(e) *Professional Behaviour* – to comply with relevant laws and regulations and avoid any action that discredits the profession.

500.6 It is important for an insolvency practitioner to be aware of the intention of this section of the Code. An insolvency practitioner shall look to and comply with the fundamental principles and not merely focus on the specific situations analysed in this section. All of the fundamental principles are important. They direct the attention of an insolvency practitioner to the overriding importance of professional ethics in his professional life. They are as important in the acceptance and conduct of liquidation and insolvency work as in any other area of professional life.

500.7 As it is the fundamental principle of objectivity that more frequently gives rise to ethical dilemmas, this section of the Code provides more specific guidance primarily in respect of objectivity. The preservation of objectivity needs to be demonstrated by the maintenance of an insolvency practitioner's independence from influences, which could affect his objectivity. An insolvency practitioner shall not only be satisfied as to the actual objectivity which he can bring to his judgement, decisions and conduct, but shall also be mindful of how his objectivity may be perceived by others. An insolvency practitioner shall also be aware of the possible threat to objectivity if he engages in regular or reciprocal arrangements in relation to appointments with another practice or organisation.

Framework Approach

500.8 Paragraphs 100.6 to 100.11 of this Code set out the conceptual framework approach that requires a professional accountant to:

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

(b) evaluate such threats; and

(c) address such threats in an appropriate manner.

500.9 This section of the Code provides a framework which insolvency practitioners can use to identify actual or potential threats to compliance with the fundamental principles, and determine whether there are any safeguards that may be available to mitigate them. As well as including illustrative guidance, it includes examples of specific threats and possible safeguards. These examples are illustrative only and are not intended to be, nor should they be interpreted as an exhaustive list of all relevant threats or safeguards. It is impossible to define all circumstances that may create threats to compliance with the fundamental principles or to specify safeguards that may be available.

Identification of threats to the fundamental principles

500.10 An insolvency practitioner shall take reasonable steps to identify the existence of any threats to compliance with the fundamental principles which arise during the course of his professional work.

500.11 An insolvency practitioner shall take particular care to identify the existence of threats which exist prior to or at the time of taking an appointment or which, at that stage, may reasonably be expected to arise during the course of such an appointment. Paragraphs on accepting or not accepting appointments and professional and personal relationships below contain particular factors an insolvency practitioner shall take into account when deciding whether to accept an appointment.

500.12 In identifying the existence of any threats, an insolvency practitioner shall have regard to relationships whereby the practice is held out as being part of a network, which is aimed at (a) co-operation and (b) profit or cost sharing or which shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand-name, or a significant part of professional resources.

500.13 Many threats fall into one or more of five categories:

(a) *Self-interest threat* – The threat that a financial or other interest will inappropriately influence the insolvency practitioner's judgement or behaviour;

(b) *Self-review threat* – The threat that an insolvency practitioner will not appropriately evaluate the results of a previous judgement made or service performed by him, or by another individual within his practice or employing practice, on which the insolvency practitioner will rely when forming a judgement as part of providing a current service;

(c) *Advocacy threat* – The threat that an insolvency practitioner or an individual within the practice will promote a position to the point that the insolvency practitioner's objectivity is compromised;

(d) *Familiarity threat* – The threat that due to a long or close relationship with others**,** an insolvency practitioner or an individual within the practice will be too sympathetic to the interests of others or too accepting of the work of others; and

(e) *Intimidation threat* – The threat that an insolvency practitioner will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the insolvency practitioner.

500.14 The following paragraphs give examples of the possible threats that an insolvency practitioner may face. These examples are illustrative only and they are not intended to be, nor should they be interpreted as an exhaustive list of all relevant threats.

500.15 Examples of circumstances that may create self-interest threats for an insolvency practitioner include:

(a) An individual within the practice having an interest in a creditor or potential creditor with a claim which requires adjudication.

(b) Concern about the possibility of damaging a business relationship.

(c) Concern about potential future employment.

500.16 Examples of circumstances that may create self-review threats include:

(a) The acceptance of an appointment in respect of an entity where an individual within the practice has recently been employed by or seconded to that entity.

(b) An insolvency practitioner or the practice has carried out professional work of any description, including sequential appointments, for that entity.

Such self-review threats may diminish over the passage of time.

500.17 Examples of circumstances that may create advocacy threats include:

(a) Acting or having acted in an advisory capacity for a creditor of an entity which subsequently becomes insolvent.

(b) Acting or having acted as an advocate for a client in litigation or dispute with an entity which subsequently becomes insolvent.

500.18 Examples of circumstances that may create familiarity threats include:

(a) An individual within the practice having a close relationship with any individual having a financial interest in the entity.

(b) An individual within the practice having a close relationship with a potential purchaser of an insolvent entity's assets and/or business.

In this regard a close relationship includes both a close professional relationship and a close personal relationship.

500.19 Examples of circumstances that may create intimidation threats include:

(a) The threat of dismissal or replacement being used to:

(i) apply pressure not to follow regulations, this section of the Code, any other applicable code, technical or professional standards.

(ii) exert influence over an appointment where the insolvency practitioner is an employee rather than a principal of the practice.

(b) Being threatened with litigation.

(c) The threat of a complaint being made to the insolvency practitioner's professional body and/or his employer.

Evaluation of threats

500.20 An insolvency practitioner shall take reasonable steps to evaluate any threats to compliance with the fundamental principles when he knows, or could reasonably be expected to know, of circumstances or relationships that may compromise compliance with the fundamental principles.

500.21 An insolvency practitioner shall exercise judgment to determine how best to deal with threats that are not at an acceptable level, whether by applying safeguards to eliminate the threat or reduce it to an acceptable level or, particularly where this is not possible, by terminating or declining the relevant appointment. In exercising this judgment, an insolvency practitioner shall consider whether a reasonable and informed third party, weighing all the specific facts and circumstances available to him at that time, would be likely to conclude that the threats would be eliminated or reduced to an acceptable level by the application of safeguards, such that compliance with the fundamental principles is not compromised. This consideration will be affected by matters such as the significance of the threat, the nature of the appointment and the structure of the practice.

Possible safeguards

500.22 Having identified and evaluated threats to compliance with the fundamental principles, an insolvency practitioner shall determine whether appropriate safeguards are available and can be applied to eliminate the threats or reduce them to an acceptable level. The relevant safeguards will vary depending on the circumstances. Generally, safeguards fall into two broad categories. Firstly, safeguards created by the profession, legislation or regulation. Secondly, safeguards in the work environment. In the insolvency or liquidation context, safeguards in the work environment can include safeguards specific to an appointment. These are considered in the paragraphs on accepting or not accepting appointments below. In addition, safeguards can be introduced across the practice. These safeguards seek to create a work environment in which threats are identified and the introduction of appropriate safeguards is encouraged. Some examples include:

(a) Leadership of the practice that stresses the importance of compliance with the fundamental principles.

(b) Policies and procedures to implement and monitor quality control of appointments.

(c) Documented policies regarding the need to identify threats to compliance with the fundamental principles, evaluate the significance of those threats, and apply safeguards to eliminate or reduce the threats to an acceptable level or, when appropriate safeguards are not available or cannot be applied, terminate or decline the relevant appointment.

(d) Documented internal policies and procedures requiring compliance with the fundamental principles.

(e) Policies and procedures to consider the fundamental principles of this section of the Code before the acceptance of an appointment.

(f) Policies and procedures that will enable the identification of interests or relationships between the insolvency practitioner or the practice or individuals within the practice and third parties.

(g) Policies and procedures to prohibit individuals (including those who are not members of the insolvency team) from inappropriately influencing the outcome of an appointment.

(h) Timely communication of a practice's policies and procedures, including any changes to them, to all individuals within the practice, and appropriate training and education on such policies and procedures.

(i) Designating a member of senior management to be responsible for overseeing the adequate functioning of the practice's quality control system.

(j) A disciplinary mechanism to promote compliance with policies and procedures.

(k) Published policies and procedures to encourage and empower individuals within the practice to communicate to senior levels within the practice and/or the insolvency practitioner any issue relating to compliance with the fundamental principles that concerns them.

Part 2 – Specific Application

Accepting or Not Accepting Appointments

500.23 The practice of liquidation and insolvency is principally governed by statute and secondary legislation and in many cases is subject ultimately to the control of the court. Where circumstances are dealt with by statute or secondary legislation, an insolvency practitioner shall comply with such provisions. An insolvency practitioner shall also comply with any relevant judicial authority relating to his conduct and any directions given by the court.

500.24 An insolvency practitioner shall act in a manner appropriate to his position as an officer of the court (where applicable) and in accordance with any fiduciary or other duties that he may be under.

500.25 Before accepting an appointment (including a joint appointment), an insolvency practitioner shall determine whether acceptance would create any threats to compliance with the fundamental principles. Of particular importance will be any threats to the fundamental principles of objectivity and integrity created by conflicts of interest or by any significant professional or personal relationships. These are considered in more detail below.

500.26 In considering whether objectivity or integrity may be threatened, an insolvency practitioner shall identify and evaluate any professional or personal relationship (see paragraphs 500.54 to 500.57 below dealing with the assets of an entity) which may affect compliance with the fundamental principles. The appropriate response to the threats arising from any such relationships shall then be considered, together with the introduction of any possible safeguards.

500.27 Generally, it will be inappropriate for an insolvency practitioner to accept an appointment where a threat to the fundamental principles exists or may reasonably be expected to arise during the course of the appointment unless:

(a) prior to the appointment, disclosure of the existence of such a threat is made to the court or to the creditors on whose behalf the insolvency practitioner would be appointed to act and no objection is made to the insolvency practitioner being appointed; and

(b) if the threat is other than trivial, safeguards are or will be available to eliminate or reduce that threat to an acceptable level.

500.28 The following are among the safeguards that may be considered:

(a) Involving and/or consulting another insolvency practitioner from within the practice to review the work done.

(b) Consulting an independent third party, such as a creditors' committee, a professional body or another insolvency practitioner.

(c) Involving another insolvency practitioner to perform part of the work, which may include another insolvency practitioner taking a joint appointment where the conflict arises during the course of the appointment.

(d) Obtaining legal advice from a solicitor or barrister with appropriate experience and expertise.

(e) Changing the members of the insolvency team.

(f) The use of separate insolvency practitioners and/or staff.

(g) Procedures to prevent access to information (e.g. strict physical separation of such insolvency teams, confidential and secure data filing).

(h) Clear guidelines for individuals within the practice on issues of security and confidentiality.

(i) The use of confidentiality agreements signed by individuals within the practice.

(j) Regular review of the application of safeguards by a senior individual within the practice not involved with the appointment.

(k) Terminating the financial or business relationship that gives rise to the threat.

(l) Seeking directions from the court.

500.29 As regards joint appointments, where an insolvency practitioner is specifically precluded by this section of the Code from accepting an appointment as an individual, a joint appointment will not be an appropriate safeguard and will not make accepting the appointment appropriate.

500.30 In deciding whether to take an appointment in circumstances where a threat to the fundamental principles has been identified, an insolvency practitioner shall consider whether the interests of those on whose behalf he would be appointed to act would best be served by the appointment of another insolvency practitioner who does not face the same threat and, if so, whether any such appropriately qualified and experienced other insolvency practitioner is likely to be available to be appointed.

500.31 An insolvency practitioner may encounter situations where no safeguards can reduce a threat to an acceptable level. Where this is the case, an insolvency practitioner shall conclude that it is not appropriate to accept the appointment.

500.32 Following acceptance of an appointment, any threats shall continue to be kept under appropriate review and an insolvency practitioner shall be mindful that other threats may come to light or arise. There may be occasions when the insolvency practitioner is no longer in compliance with this section of the Code because of changed circumstances or something that has been inadvertently overlooked. This would generally not be an issue, provided the insolvency practitioner has appropriate quality control policies and procedures in place to deal with such matters and, once discovered, the matter is corrected promptly and any necessary safeguards are applied**.** In deciding whether to continue an appointment, the insolvency practitioner may take into account the wishes of the creditors, who after full disclosure has been made have the right to retain or replace the insolvency practitioner.

500.33 In all cases an insolvency practitioner shall exercise his judgment to determine how best to deal with an identified threat. In exercising his judgment, an insolvency practitioner shall take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the insolvency practitioner at the time, including the significance of the threat and the efficacy of the safeguards applied, would be likely to conclude that the threats would be eliminated or reduced to an acceptable level by the application of the safeguards, such that compliance with the fundamental principles would not be compromised. This consideration will be affected by matters such as the significance of the threat, the nature of the work and the structure of the practice.

Conflicts of interest

500.34 An insolvency practitioner shall take reasonable steps to identify circumstances that could pose a conflict of interest. Such circumstances may create threats to compliance with the fundamental principles. Examples of where a conflict of interest may arise are where:

(a) An insolvency practitioner has deal with claims between the separate and conflicting interests of entities over which he is appointed. He should be particularly aware of the difficulties likely to arise from the existence of inter-company transactions or guarantees in group, associated or “family-connected” company situations. Acceptance of an appointment in relation to more than one company in the group or association may

raise issues of conflict of interest. Nevertheless it may be impracticable for a series of different insolvency practitioners to act. An insolvency practitioner therefore should not accept multiple appointments in such situations unless he is satisfied that he is able to take steps to minimise potential conflicts and that his overall integrity and objectivity are, and are seen to be maintained.

(b) There are a succession of or sequential appointments (see examples in category B of Part 3 on the application of the framework to specific situations).

(c) A significant relationship has existed with the entity or someone connected with the entity (see also paragraphs 500.49 to 500.53 below on professional and personal relationships). An insolvency practitioner, or a member of his practice, who is acting as insolvency practitioner in relation to an individual debtor may be asked to accept an appointment in relation to an entity of which the debtor is a major shareholder or creditor or where the entity is a creditor of the debtor. It is essential that, if the insolvency practitioner is to accept the new appointment, he should be able to show that the steps indicated in paragraph 500.34(a) above have been taken. Similar considerations apply if it is the entity appointment which precedes the individual appointment.

500.35 It is important to note that conflicts may arise not only at the time an appointment is offered but also after it has been accepted. It is always a matter for an insolvency practitioner to assess whether he may accept and/or continue an engagement in the particular context that applies at the time. It will always be up to an insolvency practitioner to justify his actions in cases of doubt. Whether an insolvency practitioner takes or continues an appointment will depend on what threats there are and whether, in the event that there are threats, the introduction of safeguards will overcome those threats. Sometimes, though, the mere perception of risk or conflict will make acceptance or continuation unwise so that the insolvency practitioner shall not only be satisfied as to the actual objectivity which he can bring to his judgment, decisions and conduct but also shall be mindful of how his objectivity could be perceived by others.

500.36 Some of the safeguards listed at paragraph 500.28 may be applied to reduce the threats created by a conflict of interest to an acceptable level. Where a conflict of interest arises, the preservation of confidentiality will be of paramount importance; therefore, the safeguards used should generally include the use of effective information barriers.

Practice mergers

500.37 Where practices merge, they shall subsequently be treated as one for the purposes of assessing threats to the fundamental principles. At the time of the merger, existing appointments shall be reviewed and any threats identified. Principals and employees of the merged practice become subject to common ethical constraints in relation to accepting new appointments to clients of either of the former practices. However, existing appointments which are rendered in apparent breach of this section of the Code by such a merger need not be determined automatically, provided that a considered review of the situation by the practice discloses no obvious and immediate ethical conflict.

500.38 Where an individual within the practice has, in any former practice, undertaken work upon the affairs of an entity in a capacity that is incompatible with an appointment of the new practice, the individual shall not personally work or be employed on that assignment.

Transparency

500.39 Both before and during an appointment an insolvency practitioner may acquire personal information that is not directly relevant to the insolvency or confidential commercial information relating to the affairs of third parties. The information may be such that others might expect that confidentiality would be maintained.

500.40 An insolvency practitioner in the role as office holder has a professional duty to report openly to those with an interest in the outcome of the insolvency or liquidation. An insolvency practitioner shall report on his acts and dealings as fully as possible having regard to the circumstances of the case, in a way that is transparent and understandable. An insolvency practitioner shall bear in mind the expectations of others and what a reasonable and informed third party would consider appropriate.

Professional competence and due care

500.41 Prior to accepting an appointment an insolvency practitioner, to the extent reasonably possible, shall ensure that he is satisfied that the following matters have been taken into consideration:

(a) Obtaining knowledge and understanding of the entity, its owners, managers and those responsible for its governance and business activities.

(b) Acquiring an appropriate understanding of the nature of the entity's business, the complexity of its operations, the specific requirements of the engagement and the purpose, nature and scope of the work to be performed.

(c) Acquiring knowledge of relevant industries or subject matters.

(d) Possessing or obtaining experience with relevant regulatory or reporting requirements.

(e) Assigning sufficient staff with the necessary competencies.

(f) Using experts where necessary.

(g) Complying with quality control policies and procedures designed to provide reasonable assurance that specific engagements are accepted only when they can be performed competently.

500.42 The fundamental principle of professional competence and due care imposes an obligation on an insolvency practitioner to only accept an appointment that the insolvency practitioner is competent to perform. For example, a self-interest threat to professional competence and due care is created if the insolvency team does not possess or cannot acquire the competencies necessary to properly carry out the appointment. Expertise will include appropriate training, technical knowledge, knowledge of the entity and the business with which the entity is concerned.

500.43 If any appointment necessitates the employment of agents, an insolvency practitioner shall exercise care to retain overall control of the conduct of the engagement. An insolvency practitioner shall not accept any insolvency or liquidation work as agent of another insolvency practitioner unless satisfied that he has been employed on this basis and the other insolvency practitioner has retained overall control of the conduct of the engagement.

500.44 Maintaining and acquiring professional competence requires a continuing awareness and an understanding of relevant technical, professional and business developments, including:

(a) Developments in insolvency and related legislation.

(b) The regulations of the Institute, including the continuing professional development requirements.

(c) Guidance issued by the Institute, e.g. Insolvency Guidance Notes, and relevant circulars issued by regulatory bodies.

(d) Technical issues being discussed within the profession.

Professional and Personal Relationships

500.45 The environment in which an insolvency practitioner works and the relationships formed in his professional and personal life can lead to threats to compliance with the fundamental principle of objectivity.

Identifying relationships

500.46 In particular, the principle of objectivity may be threatened if any individual within the practice, the close relative of an individual within the practice, or the practice itself, has or has had a professional or personal relationship which relates to the appointment being considered.

500.47 Professional or personal relationships may include, but are not restricted to, relationships with:

(a) the entity;

(b) any director or shadow director or former director or shadow director of the entity;

(c) shareholders of the entity;

(d) any principal or employee of the entity;

(e) business partners of the entity;

(f) companies or entities controlled by the entity;

(g) companies which are under common control;

(h) creditors (including debenture holders or floating charge holders) of the entity;

(i) debtors of the entity;

(j) close relative of the entity (if an individual) or its officers (if a corporate body);

(k) others with commercial relationships with the practice.

500.48 A practice shall have policies and procedures to identify relationships between individuals within the practice and third parties in a way that is proportionate and reasonable in relation to the appointment being considered.

Is the relationship significant to the conduct of the appointment?

500.49 Where a professional or personal relationship of the type described in paragraph 500.46 has been identified, an insolvency practitioner shall evaluate the impact of the relationship in the context of the appointment being sought or considered. Issues to consider in evaluating whether a relationship creates a threat to compliance with the fundamental principles may include the following:

(a) The nature of the previous duties undertaken by a practice during an earlier relationship with the entity.

(b) The impact of the work conducted by the practice on the financial state and/or the financial stability of the entity in respect of which the appointment is being considered.

(c) Whether the fee received for the work by the practice is or was significant to the practice itself or is or was substantial.

(d) How recently any professional work was carried out. It is likely that greater threats will arise (or may be seen to arise) where work has been carried out within the previous two years. However, there may still be instances where, in respect of non-audit work, any threat is at an acceptable level. Conversely, there may be situations whereby the nature of the work carried out was such that a considerably longer period should elapse before any threat can be reduced to an acceptable level.

(e) Whether the appointment being considered involves consideration of any work previously undertaken by the practice for that entity.

(f) The nature of any personal relationship and the proximity of the insolvency practitioner to the individual with whom the relationship exists and, where appropriate, the proximity of that individual to the entity in relation to which the appointment relates.

(g) Whether any reporting obligations will arise in respect of the relevant individual with whom the relationship exists (e.g. an obligation to report on the conduct of directors and shadow directors of a company to which the appointment relates).

(h) The nature of any previous duties undertaken by an individual within the practice during any earlier relationship with the entity.

(i) The extent of the insolvency team's familiarity with the individuals connected with the entity.

500.50 Having identified and evaluated a relationship that may create a threat to compliance with the fundamental principles, an insolvency practitioner shall consider his response including the introduction of any possible safeguards to reduce the threat to an acceptable level.

500.51 Some of the safeguards which may be considered to reduce the threat created by a professional or personal relationship to an acceptable level are considered in paragraph 500.28. Other safeguards may include:

(a) Withdrawing from the insolvency team.

(b) Terminating (where possible) the financial or business relationship giving rise to the threat.

(c) Disclosure of the relationship and any financial benefit received by the practice (whether directly or indirectly) to the entity or to those on whose behalf the insolvency practitioner would be appointed to act.

500.52 An insolvency practitioner may encounter situations in which no or no reasonable safeguards can be introduced to eliminate a threat arising from a professional or personal relationship, or to reduce it to an acceptable level. In such situations, the relationship in question will constitute a significant professional relationship or a significant personal relationship. Where this is the case, the insolvency practitioner shall conclude that it is not appropriate for him or any member of his practice to take the appointment.

500.53 Consideration should always be given to the perception of others when deciding whether to accept an appointment. Whilst an insolvency practitioner may regard a relationship as not being significant to the appointment, the perception of others may differ and this may in some circumstances be sufficient to make the relationship significant.

Dealing with the Assets of an Entity

500.54 Actual or perceived threats (for example self-interest threats) to compliance with the fundamental principles may arise when during an appointment, an insolvency practitioner realises assets.

500.55 An insolvency practitioner appointed to, or who is providing services which may lead to an appointment in relation to an entity shall not acquire, directly or indirectly, any of the assets of the entity. An insolvency practitioner shall not knowingly permit any individual within the practice, or any close relative of the insolvency practitioner or of an individual within the practice, directly or indirectly, to do so, save in circumstances which clearly do not impair the insolvency practitioner's objectivity.

500.56 Where the assets and business of an insolvent company are sold by an insolvency practitioner shortly after appointment on pre-agreed terms, this could lead to an actual or perceived threat to objectivity. The sale may also be seen as a threat to objectivity by creditors or others not involved in the prior agreement. The threat to objectivity may be eliminated or reduced to an acceptable level by safeguards such as obtaining an independent valuation of the assets or business being sold, or the consideration of other potential purchasers.

500.57 It is also particularly important for an insolvency practitioner to take care to ensure (where to do so does not conflict with any legal or professional obligation) that his decision making processes are transparent, understandable and readily identifiable to all third parties who may be affected by the sale or proposed sale.

Obtaining Specialist Advice and Services

500.58 When an insolvency practitioner intends to rely on the advice or work of another, the insolvency practitioner shall evaluate whether such reliance is warranted. The insolvency practitioner shall consider factors such as reputation, expertise, resources available and applicable professional and ethical standards. Any payment to the third party shall reflect the value of the work undertaken.

500.59 Threats to compliance with the fundamental principles (for example familiarity threats and self-interest threats) can arise if services are provided by a regular source even if it is independent of the practice.

500.60 Safeguards should be introduced to eliminate such threats or reduce them to an acceptable level. These safeguards should ensure that a proper business relationship is maintained between the parties and that such relationships are reviewed periodically to ensure that best value and service are being obtained in relation to each appointment. Additional safeguards may include clear guidelines and policies within the practice on such relationships. An insolvency practitioner shall also consider disclosure of the existence of such business relationships to the general body of creditors or the creditor’s committee if one exists.

500.61 Threats to compliance with the fundamental principles can also arise where services are provided from within the practice or by a party with whom the practice, or an individual within the practice, has a business or personal relationship. An insolvency practitioner shall take particular care in such circumstances to ensure that the best value and service are being provided.

Fees and Other Types of Remuneration

500.62 Where an engagement may lead to an appointment, an insolvency practitioner shall make any party to the work aware of the terms of the work and, in particular, the basis on which any fees are charged and which services are covered by those fees.

500.63 An insolvency practitioner shall not accept referral fees or commissions in relation to an appointment, as accepting referral fees or commissions could represent a significant threat to objectivity. For the avoidance of doubt, any amounts paid on account of liquidation costs (including the insolvency practitioner's fees and expenses) should not be regarded as referral fees or commissions and are not prohibited by this paragraph.

500.64 Insolvency practitioners should note that under the Prevention of Bribery Ordinance (Cap. 201), there are provisions governing acceptance of any payment by someone who is in an agent-principal relationship with another person. For example, if an agent receives payment from another for doing something or showing favour to another in relation to the affairs or business of the agent's principal (who may be the agent's employer or in some other relationships with the agent which involve trust and confidence), the permission of the principal should be obtained first before receiving the payment in order to avoid the risk of contravening the Prevention of Bribery Ordinance. The same principle applies to someone who is paying another person who is in an agent-principal relationship with some other person: the payer should ensure that the agent has obtained permission from his principal for receiving the payment. Whether an agent-principal relationship exists in any given situation depends on the facts of each case. Insolvency practitioners should consult their own legal advisers as and when necessary.

Obtaining Appointments

500.65 The special nature of appointments makes the payment or offer of any commission for, or the furnishing of any valuable consideration towards, the introduction of such appointments inappropriate. For the avoidance of doubt, this does not, however, preclude:

(a) An arrangement between an insolvency practitioner and his practice's employee whereby the employee's remuneration is based in whole or in part on introductions obtained for the insolvency practitioner through the efforts of the employee.

(b) Change of appointment resulting from transfer/sale of an existing practice due to, e.g., the sale or merger of an insolvency practice or retirement of the outgoing insolvency practitioner (owner of the practice).

500.66 When an insolvency practitioner solicits an appointment or work that may lead to an appointment through advertising or other forms of marketing, there may be threats to compliance with the fundamental principles.

500.67 An insolvency practitioner shall satisfy himself that any advertising or other form of marketing in relation to soliciting appointments:

(a) Is fair and not misleading.

(b) Avoids unsubstantiated or disparaging statements.

(c) Complies with other codes of practice and guidance in relation to advertising, where applicable. For example, members of the Institute shall take note of section 250 of the Code "Marketing Professional Services" and section 450 of the Code "Practice Promotion".

500.68 Advertisements and other forms of marketing should be clearly identified as such and conform to the basic principles of legality, decency, clarity, honesty and truthfulness.

500.69 If reference is made in advertisements or other forms of marketing to fees or to the cost of the services to be provided, the basis of calculation and the range of services that the reference is intended to cover should be provided. Care should be taken to ensure that such references do not mislead as to the precise range of services and the time commitment that the reference is intended to cover.

500.70 An insolvency practitioner shall never promote or seek to promote his services, or the services of another insolvency practitioner, in such a way, or to such an extent as to amount to harassment.

500.71 Where an insolvency practitioner or the practice advertises for work via a third party, the insolvency practitioner is responsible for ensuring that the third party follows the above guidance.

Gifts and Hospitality

500.72 An insolvency practitioner, or a close relative, may be offered gifts and hospitality. In relation to an appointment, such an offer may create threats to compliance with the fundamental principles. For example, self-interest or familiarity threats to objectivity may be created if a gift is accepted; and intimidation threats to objectivity may result from the possibility of such offers being made public.

500.73 The existence and significance of any threat will depend on the nature, value and intent of the offer. Where gifts or hospitality are offered that a reasonable and informed third party, weighing all the specific facts and circumstances, would consider trivial and inconsequential, an insolvency practitioner may conclude that the offer is made in the normal course of business without the specific intent to influence decision making or obtain information. In such cases, the insolvency practitioner may generally conclude that any threat to compliance with the fundamental principles is at an acceptable level.

500.74 An insolvency practitioner shall evaluate the significance of any threats and apply safeguards when necessary to eliminate the threats or reduce them to an acceptable level. When the threats cannot be eliminated or reduced to an acceptable level through the application of safeguards, an insolvency practitioner shall not accept such an offer.

500.75 In the light of the above, an insolvency practitioner shall also not offer or provide gifts or hospitality where this would give rise to an unacceptable threat to compliance with the fundamental principles.

500.76 An insolvency practitioner should also note the implications of the Prevention of Bribery Ordinance (Cap. 201) when accepting and/or offering advantages (including gifts). If in doubt legal advice should be sought.

Record Keeping

500.77 It will always be for an insolvency practitioner to justify his actions. An insolvency practitioner will be expected to be able to demonstrate the steps that he took and the conclusions that he reached in identifying, evaluating and responding to any threats, both leading up to and during an appointment, by reference to written contemporaneous records.

500.78 The records an insolvency practitioner maintains, in relation to the steps that he took and the conclusions that he reached, should be sufficient to enable a reasonable and informed third party to reach a view on the appropriateness of his actions.

Part 3 – The Application of the Framework to Specific Situations

Introduction to specific situations

500.79 The general principle is that it is inappropriate for an insolvency practitioner or any member of his practice to accept an appointment where a threat to the fundamental principles exists or may reasonably be expected to arise during the course of the appointment where safeguards are not or will not become available to eliminate such a threat, or to reduce it to an acceptable level (see paragraph 500.27). The following examples outline some specific circumstances and professional or personal relationships that will create threats to compliance with the fundamental principles. The examples may also assist members of the insolvency team to assess the implications of similar, but different, circumstances and relationships.

500.80 The examples are divided into two categories. Category A are examples which do not relate to a previous or existing appointment while Category B are examples that do relate to a previous or existing appointment. The examples are not intended to be exhaustive and should not be treated as such.

Category A Examples that do not relate to a previous or existing appointment

500.81 The following situations involve a professional relationship which does not consist of a previous appointment.

500.82 **Appointment following audit related work**

Relationship:

The practice or an individual within the practice has previously carried out audit related work within the previous two years.

Response:

Except in the case of a members' voluntary liquidation, as provided for below, and in some limited circumstances in relation to an insolvent scheme of arrangement, as provided for in paragraph 500.85, a significant professional relationship[1] will arise. An insolvency practitioner should conclude that it is not appropriate to take the appointment, whether that appointment be as liquidator, provisional liquidator, special manager, receiver (and manager), trustee in bankruptcy, provisional trustee in bankruptcy, nominee of an individual voluntary arrangement, or any other appointment referred to in paragraph 500.4 .

Where audit related work was carried out more than two years before the proposed date of the appointment of the insolvency practitioner, a threat to compliance with the fundamental principles may still arise. The insolvency practitioner should evaluate any such threat and consider whether the threat can be eliminated or reduced to an acceptable level by the existence or introduction of safeguards, including disclosure to creditors of the previous professional relationship.

This restriction does not apply where the appointment is in relation to a members' voluntary liquidation. An insolvency practitioner is not generally prevented from taking an appointment as liquidator in a members' voluntary liquidation in this situation. However, the insolvency practitioner should consider whether there are any other circumstances that give rise to an unacceptable threat to compliance with the fundamental principles. Further, the insolvency practitioner should satisfy himself that the directors' certificate of solvency in a members' voluntary liquidation is likely to be substantiated by events.

---

1 See paragraphs 500.49 to 500.53.

500.83 **Appointment – relationship with the holder of a debenture or floating charge**

Relationship:

An insolvency practitioner, or an individual within his practice, has a personal or close and distinct business connection with the debenture holder or the floating charge holder.

Response:

An insolvency practitioner should, in general, decline to accept an appointment in relation to an entity if he, or a member of his practice, has a personal or close and distinct business connection with the debenture holder or the floating charge holder of the entity as might impair or appear to impair the insolvency practitioner's objectivity. Under normal circumstance, it is not considered likely that a close and distinct business connection would normally exist between an insolvency practitioner and, for example, a major financial institution simply because he is a retail customer of that institution. However, such a close and distinct business connection would exist where the insolvency practitioner, or a member of his practice, holds an appointment over such a financial institution.

500.84 **Appointment following appointment as investigating accountant**

Relationship:

The practice or a member of the practice was instructed by, or at the instigation of, a creditor or other party having an actual or potential financial interest in an entity to investigate, monitor or advise on its affairs.

Response:

A significant professional relationship would not normally arise in these circumstances provided that there has not been a direct involvement by an individual within the practice in the management of the entity or business. If the circumstances of the initial appointment were such as to prevent open discussion of the financial affairs of the entity with the directors, the investigating member or other individuals within the practice may be called upon to justify the propriety of their acceptance of the subsequent appointment.

500.85 **Appointment as administrator, manager or adjudicator of a scheme of arrangement of an insolvent client**

Relationship:

A significant professional relationship.
Where there has been a significant professional relationship with a client, no individual within the practice unit should accept appointment as administrator, manager, adjudicator or any other similar role in respect of a scheme of arrangement of that insolvent client. However, for the purposes of this paragraph a significant professional relationship shall not be deemed to have arisen by virtue of the appointment of an individual within the practice unit as liquidator or provisional liquidator of the client.

Response:

As indicated in paragraph 500.82, where there has been a significant professional relationship with a client, no individual within the practice should accept appointment as administrator, manager, adjudicator or any other similar role in respect of a scheme of arrangement made by that insolvent client. However, this restriction may not apply in circumstances which clearly do not impair, and would not be perceived as impairing, his objectivity. This may be the situation where the scheme assets and scheme liabilities are substantially different from the assets and liabilities of the company that were previously audited. Nevertheless, in such cases, an insolvency practitioner should satisfy himself that there is no self-review threat or any other circumstances that give rise to an unacceptable threat to compliance with the fundamental principles.

Category B Examples relating to previous or existing appointments

500.86 The following situations involve a prior professional relationship that involves a previous or existing appointment.

500.87 **Appointment following appointment as receiver**

Previous/existing appointment:

An individual within the practice is, or in the previous two years has been, a receiver (or receiver and manager) of an entity or any of its assets.

Proposed appointment:

Appointment in an insolvent liquidation.

Response:

No individual within the practice should accept an appointment in relation to the entity in an insolvent liquidation. This restriction does not apply where the previous appointment was made by the court. However, before a court-appointed receiver accepts a subsequent appointment, he should disclose the position to the relevant parties. Even if the creditors do not object to the appointment, he should give careful consideration as to whether there are any circumstances that give rise to an unacceptable threat to compliance with the fundamental principles, such as whether his objectivity might be, or appear to be, impaired, and, if so, the appointment should be refused.

500.88 **Conversion of members' voluntary winding-up into creditors' voluntary winding-up**

Previous/existing appointment:

An individual within the practice has been the liquidator of a company in a members' voluntary winding-up.

Proposed appointment:

Liquidator in a members' voluntary winding-up, where it has been necessary to convene a creditors' meeting under section 237A of the Companies (Winding Up and Miscellaneous Provisions) Ordinance because it appears that the entity will be unable to pay its debts in full within the period stated in the certificate of solvency. The insolvency practitioner's continuance as liquidator will depend on whether or not he believes on reasonable grounds that the entity will eventually be able to pay its debts in full.

Response:

If the entity will not be able to pay its debts in full:

(a) Where there has been a significant professional relationship, an insolvency practitioner should not accept nomination under the creditors' winding-up.
(b) In situations where an insolvency practitioner has had no significant professional relationship, he may continue or accept an appointment as liquidator, subject to creditors' approval. However, the insolvency practitioner should consider whether there are any other circumstances that give rise to an unacceptable threat to compliance with the fundamental principles.

If the insolvency practitioner concludes that the entity will eventually be able to pay its debts in full, he may accept nomination by the creditors and continue as liquidator. However, if it should subsequently appear that this belief was mistaken, and where he has previously had a significant professional relationship, the insolvency practitioner must then resign and should not seek re-appointment.

500.89 **Trustee in bankruptcy following appointment as nominee of an individual voluntary arrangement**

Previous/existing appointment:

An individual within the practice has been the nominee of an individual voluntary arrangement in relation to a debtor.

Proposed appointment:

Trustee in bankruptcy.

Response:

An insolvency practitioner may normally accept an appointment as trustee in bankruptcy of that debtor provided that it is effected by a general meeting of creditors under the provisions of section 17 of the Bankruptcy Ordinance (Cap. 6). However, the insolvency practitioner should consider whether there are any circumstances that give rise to an unacceptable threat, in particular self-review threats, to compliance with the fundamental principles.

500.90 **Appointment as independent trustee of provident fund schemes of companies in liquidation or receivership**

Previous/existing appointment:

An insolvency practitioner who is the liquidator, provisional liquidator or receiver of a company.

Proposed appointment:

Independent Trustee of the provident fund scheme of such company.

Response:

An insolvency practitioner should not act and should not appoint an individual within his practice, or any close relative of any of the above or of himself, as “Independent Trustee” of the provident fund scheme of a company of which he is the liquidator, provisional liquidator or receiver.

500.91 **Appointment as administrator, manager or adjudicator of a scheme of arrangement of an insolvent client**

Previous/existing appointment:

An individual within the practice has been the liquidator or provisional liquidator of an insolvent company.

Proposed appointment:

Administrator, manager or adjudicator of a scheme of arrangement of such company.

Response:

An insolvency practitioner may normally accept an appointment as administrator, manager or adjudicator of a scheme of arrangement of an insolvent client. However, when considering whether to accept such appointments, an insolvency practitioner should satisfy himself that there are no circumstances that give rise to an unacceptable threat, in particular self-review threat, to compliance with the fundamental principles.

Definitions

500.92 In section 500 of the Code, the following expressions have the following meanings:

Close relative	Includes a spouse (or equivalent), dependant, parent, grandparent, child or sibling, parents' sibling and his child.
Code	Code of Ethics for Professional Accountants issued by the Hong Kong Institute of Certified Public Accountants.
Entity	*Any natural or legal person or any group of such persons, including a partnership.*
He/she	In this section, "he" is to be read as including "she".
Individual within the practice	The insolvency practitioner, any principals in the practice and any employees within the practice.
Institute	Hong Kong Institute of Certified Public Accountants.
Insolvency practitioner	An individual who has been appointed in respect of an appointment referred to in paragraph 500.4, or who provides professional services which may lead to such an appointment.
Insolvency team	An insolvency practitioner and any person under the control or direction of the insolvency practitioner.
Practice	The organisation in which the insolvency practitioner practises.
Principal	In respect of a practice: (a) which is a company: a director; (b) which is a partnership: a partner; (c) which is comprised of a sole practitioner: that person; Alternatively any person within the practice who is held out as being director or partner.

Effective Date

500.93 This section of the Code is effective on 1 April 2012.

PART F – GUIDELINES ON ANTI-MONEY LAUNDERING AND COUNTER-TERRORIST FINANCING FOR PROFESSIONAL ACCOUNTANTS

Pages

Section 600 Overview and Application .....206 - 210
Section 610 AML/CFT Policies, Procedures and Controls .....211 - 214
Section 620 Customer Due Diligence .....215 - 228
Section 630 Ongoing Monitoring.....229 - 230
Section 640 Making Suspicious Transaction Reports .....231 - 238
Section 650 Financial Sanctions and Terrorist Financing .....239 - 241
Section 660 Record Keeping .....242 - 243
Section 670 Staff Hiring and Training .....244 - 245
Appendix A – E .....246 - 268

Preamble

The Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Ordinance 2018, effective on 1 March 2018, extends the scope of the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615)("AMLO") to cover "designated non-financial businesses and professions" ("DNFBPs"), including accountants. It implements the FATFRs as these relate to customer due diligence ("CDD") and record keeping ("RK") for DNFBPs. These Guidelines are based on AMLO as amended, now entitled the Anti-Money Laundering and Counter-Terrorist Financing Ordinance, and subsequent references to "AMLO" relate to the amended ordinance. These Guidelines are effective as from 1 March 2018.

SECTION 600

Overview and Application

600.1 Introduction and purpose of Guidelines

600.1.1 These Guidelines are published under section 7 of AMLO. They apply primarily to practices and members working in practices. Reference to "practices" in the Guidelines includes practice units under the Professional Accountants Ordinance (Cap. 50) and also trust or company service providers, where the proprietors, partners or directors are all members. Reference to "practices" should also be taken to include references to members working in practices, where the context may be so construed. The Guidelines should also provide useful information for members generally[1].

600.1.2 In addition to AMLO, and in particular Schedule 2 of AMLO, these Guidelines also make reference to other existing legislation containing requirements relating to AML/ CFT, principally, the Drug Trafficking (Recovery of Proceeds) Ordinance (Cap. 405) ("DTROP"), the Organised and Serious Crimes Ordinance (Cap. 455) ("OSCO") and the United Nations (Anti-Terrorism Measures) Ordinance (Cap. 575) ("UNATMO"). AMLO and relevant sections of the other ordinances together seek to give effect to the FATFRs. As a member of FATF, Hong Kong is required to implement a credible AML/CFT regime having regard to the FATFRs, substantial parts of which apply to DNFBPs as well as to financial institutions ("FIs").

600.1.3 It is recognised that, in contrast to certain FIs, practices are not licensed to hold client monies or process cash transactions, so generally money laundering/ terrorist financing ("ML/TF") risks may be lower for practices than for FIs.

600.1.4 At the same time, members are bound by the Code of Ethics for Professional Accountants to conduct themselves with integrity and professionalism and to act in the public interest, not only the interests of their clients. Practices will therefore be expected by the community to have in place adequate CDD or "know your client" procedures and arrangements for maintaining documentation, to minimise any risk of involvement in ML/TF.

1 Members working in the financial services or other sectors specified in AMLO are advised to familiarise themselves with any guidelines issued by the appropriate relevant authority or regulatory body under AMLO to facilitate compliance with the requirements of the ordinance.

600.1.5 Against the above background, these Guidelines are intended to:

- Provide general guidance on AML/CFT requirements under AMLO and other relevant legislation.
- Indicate good practice on applying other relevant FATFRs.
- Summarise relevant legislative provisions on AML/CFT.
- Ensure compliance by members with prescribed requirements to prevent ML/TF activities.

600.1.6 It should be noted that, while these Guidelines require compliance by practices with certain provisions, they do not constitute legal advice and, in case of doubt, members should consider seeking their own legal advice.

600.1.7 A failure by a practice to comply with a provision in these Guidelines does not by itself render the practice liable to any judicial or other proceedings but, in any court proceedings under AMLO, the Guidelines are admissible in evidence; and if any provision set out in the Guidelines appears to the court to be relevant to any question arising in the proceedings, AMLO states that the provision will be taken into account in determining that question. In considering whether a practice has contravened an applicable requirement under AMLO, or other AML/CFT-related legislation, the Institute will have regard to any provision in the Guidelines that is relevant to the requirement.

600.1.8 More generally, practices that pay insufficient attention to the AML/ CFT issues covered in these Guidelines could be at greater risk of becoming unwittingly associated with ML/ TF activities, with potentially serious consequences, such as criminal prosecution and loss of reputation. In order to mitigate and address the risks, whether legal, regulatory and reputational, of being found to be involved in facilitating, or turning a blind eye to, ML/TF, it is in the interests of practices to familiarise themselves with these Guidelines and to take on board the relevant FATFRs within their risk management programmes, including those FATFRs already implemented in legislation other than AMLO, such as the requirement to report suspicious transactions under DTROP and OSCO.

600.1.9 Use of the word "must" in these Guidelines indicates a mandatory requirement, which may be a statutory obligation, or requirement that directly flows from this, or is seen by the Institute as being necessary to implement the statutory obligation effectively. In contrast, use of the words “should”, "would" and "may" in these Guidelines is not intended to indicate a mandatory requirement, but to provide guidance on possible means of compliance with statutory and regulatory requirements, and/or suggest good practice regarding compliance with the FAFTRs. Practices should consider their own particular circumstances when determining how to apply the detailed provisions of these Guidelines, and take into account the relevant legislation and mandatory requirements.

600.1.10 For terms, abbreviations and definitions used in these Guidelines members may also refer to Appendix E.

600.2 Application of the Guidelines

The Guidelines apply to practices (see paragraph 600.1.1) as follows:	AML/CTF policies, procedures and controls (section 610)	CDD, RK and ongoing monitoring (sections 620,630,660)	Suspicious transaction reporting and financial sanctions (sections 640,650)	Staff hiring and training (section 670)
When providing any service specified in paragraphs 600.2.1 or 600.2.2	**Mandatory**	**Mandatory**	**Mandatory**	**Mandatory**
When providing services other than those specified in paragraphs 600.2.1 or 600.2.2	**Good practice**	**Good practice**	**Mandatory**	**Good practice**

600.2.1 When practices, by way of business, prepare for or carry out for a client a transaction concerning one or more of the following services, there are specific CDD, ongoing monitoring and RK measures that they must adopt, as set out in Sections 620, 630 and 660:

(a) buying and selling of real estate;
(b) managing of client money, securities or other assets;
(c) management of bank, savings or securities accounts;
(d) organisation of contributions for the creation, operation or management of companies;
(e) creation, operation or management of legal persons or arrangements;
(f) buying and selling of business entities.

600.2.2 In addition, practices that provide trust or company services must adopt CDD, ongoing monitoring and RK procedures, when, by way of business, they prepare for or carry out for a client a transaction concerning any of the following services:

(a) forming corporations or other legal persons;
(b) acting as, or arranging for another person to act as, a director or secretary of a company, a partner of a partnership, or a similar position in relation to other legal persons;
(c) providing a registered office, business address or accommodation, correspondence or administrative address for a company, a partnership or any other legal person or arrangement;
(d) acting as, or arranging for another person to act as, a trustee of an express trust or similar legal arrangement; or
(e) acting, or arranging for another person to act, as a nominee shareholder for a person other than a corporation whose securities are listed on a recognised stock market.

600.2.3 The provisions of these Guidelines should be read in the context of this subsection, together with the relevant provisions of Hong Kong laws, and applied accordingly.

600.3 The nature of money laundering and terrorist financing

600.3.1 "Money laundering" ("ML") is defined in AMLO[2] to mean an act intended to have the effect of making any property:

(a) that is the proceeds obtained from the commission of an indictable offence under the laws of Hong Kong, or of any conduct which if it had occurred in Hong Kong would constitute an indictable offence under the laws of Hong Kong; or
(b) that in whole or in part, directly or indirectly, represents such proceeds, not to appear to be or so represent such proceeds.

600.3.2 "Terrorist financing" ("TF") is defined in AMLO[3] to mean:

(a) the provision or collection, by any means, directly or indirectly, of any property –
(i) with the intention that the property will be used; or
(ii) knowing that the property will be used,

in whole or in part, to commit one or more terrorist acts (whether or not the property is actually so used); or

(b) the making available of any property or financial (or related) services, by any means, directly or indirectly, to or for the benefit of a person knowing that, or being reckless as to whether, the person is a terrorist or terrorist associate; or

(c) the collection of property or solicitation of financial (or related) services, by any means, directly or indirectly, for the benefit of a person knowing that, or being reckless as to whether, the person is a terrorist or terrorist associate.

600.3.3 Terrorists or terrorist organisations require financial support in order to achieve their aims. There is often a need for them to obscure or disguise links between them and their funding sources. It follows that terrorist groups are also inclined to find ways to obscure fund movements, whether or not such funds are the proceeds of crime, in order to be able to use them without attracting the attention of the authorities.

600.4 Financial Action Task Force and legislation concerned with money laundering and terrorist financing

600.4.1 The FATF has issued the FATFRs as a framework to detect and prevent ML/TF activities. They have become a widely-accepted international benchmark and are used as the basis of, or as a reference for, legislation and regulation in many jurisdictions around the world.

600.4.2 Among the key FATFRs are those covering CDD and RK and the making of suspicious transaction reports ("STRs"), as well as AML/CFT controls and monitoring. FATF members are expected to implement statutory AML/CFT regimes to reflect the basic requirements of CDD, RK and making STRs. They apply to DNFPBs, including accountants, in relation to specified service offerings (see paragraphs 600.2.1 and 600.2.2).

600.4.3 Legislation prescribing criminal offences for involvement in ML/TF, and including requirements on making STRs, has been in place for a number of years in Hong Kong. The legislation applies to everyone in Hong Kong. It should be noted that, under the law, the requirement to make STRs is not limited to the FATF-specified services and includes a general obligation to report where there is knowledge or suspicion of ML/TF.

600.4.4 Apart from AMLO, the three main pieces of legislation in Hong Kong that are relevant to

2 AMLO, Schedule 1, Part 1.
3 Ibid.

ML/TF are DTROP, OSCO and UNATMO. It is important that practices and their staff fully understand their obligations under the respective pieces of legislation.

600.4.5 DTROP and OSCO create an offence of ML in relation to dealing with property known or believed to represent proceeds of drug trafficking specifically (under DTROP) or of an indictable offence generally (under OSCO)[4]. This is a serious offence carrying a maximum penalty of 14 years imprisonment and a fine of five million dollars.

600.4.6 DTROP, OSCO and UNATMO also contain provisions on making STRs and specify an offence of not reporting where a person has the requisite suspicion or knowledge[5]. They also specify an offence of "tipping off" in relation to making STRs (see Section 640 of these Guidelines). Additional information on the above legislation is provided in Appendix A.

4 Section 25 of DTROP and OSCO

5 Section 25A of DTROP and OSCO, and sections 12(1) and 14 of UNATMO

SECTION 610

AML/CFT Policies, Procedures and Controls

General requirements

610.1 Practices must have in place internal policies, procedures and other controls to address ML/TF concerns, and compliance with the existing legal requirements on AML/CFT, when they carry out any of the services specified in paragraphs 600.1.2 and 600.2.2 of these Guidelines, and should consider the need to do so in relation to other services that they provide. Practices should communicate these policies and procedures, etc., clearly to employees.

610.1.1 **Controls cover primarily the following areas:**

(a) risk assessment and management
(b) customer due diligence (Section 620)
(c) ongoing monitoring (Section 630)
(d) suspicious transactions reporting (Section 640)
(e) record keeping (Section 660)
(f) compliance management, including designating a Money Laundering Reporting Officer ("MLRO") at the management level
(g) staff hiring, ongoing training and communication (Section 670)
(h) group policy, where appropriate.

610.2 Adopting a risk-based approach

610.2.1 While no system can be expected to detect and prevent all ML/TF activities, practices must establish and implement adequate and appropriate AML/CFT controls (including client acceptance policies and procedures), taking into account factors such as:

- types of client involved and their geographical locations
- services/ products offered
- mode of delivery of the service/ product; and
- size of the practice.

Appendix B provides some examples of steps practices should consider taking. See also the **FATF's RBA Guidance for Accountants**.

610.2.2 A risk-based approach ("RBA") is recognised as an effective way to combat ML/TF. It helps ensure that measures to prevent or mitigate ML/TF are proportionate to the risks identified and to facilitate decisions on how to allocate resources in the most effective way.

610.2.3 While there are no universally accepted methodologies that prescribe the nature and extent of an RBA, an effective RBA involves identifying and categorising ML/TF overall risks at the client level and establishing reasonable measures based on risks identified. An effective RBA will allow practices to exercise reasonable business judgment with respect to their clients.

610.2.4 The type and extent of measures to be taken in relation to the items in paragraph 610.1.1 above should be appropriate and reasonable having regard to the risk of ML/TF. There is no one-size-fits-all approach. Some of the factors to be considered include:

- The nature, size and complexity of the practice's business
- The geographical spread of client operations and the practice's operation
- The extent to which the practice is dealing directly with the customer or through other intermediaries or third parties.

610.2.5 An effective RBA will enable practices to subject clients to proportionate controls and oversight by determining:

(a) the extent of CDD to be performed on the direct client; the extent of the measures to be undertaken to verify the identity of any beneficial owner and any person purporting to act on behalf of the client (see Section 620);
(b) the level of ongoing monitoring to be applied to the relationship (see Section 630); and
(c) measures to mitigate any risks identified.

610.2.6 A reasonably designed RBA should assist practices to effectively manage potential ML/TF risks, rather than prohibiting practices from engaging in transactions with clients or establishing business relationships with potential clients. It should also not be designed to prevent practices from finding innovative ways to diversify their business.

610.2.7 The identification of risks associated with clients, services (including delivery channels), and geographical locations, is not a static assessment and may change over time, depending on how circumstances develop, and how threats evolve. Practices may therefore have to adjust their risk assessment of a particular client from time to time, based upon information obtained, and also review the extent and frequency of the CDD and ongoing monitoring to be applied to the client. Further information on ongoing monitoring is contained in Section 630.

610.2.8 More broadly, practices should keep their policies and procedures under review and assess that their risk mitigation procedures and controls are working effectively.

610.3 Management oversight

610.3.1 The senior management of a practice are responsible for managing the business effectively and in compliance with relevant legal and regulatory requirements, which should include adequate oversight in relation to AML/CFT. As such:

(a) They must be satisfied that the AML/CFT controls are capable of addressing the practice's ML/TF identified risks;
(b) they should appoint a partner, director or equivalent as a compliance officer ("CO"), who has overall responsibility for the establishment and maintenance of the practice's AML/CFT controls; and
(c) they must appoint a senior member of the practice's staff as the MLRO, who is the central reference point for making STRs. Where appropriate, the MLRO may be the same person as the CO.

610.3.2 To enable the CO and MLRO to discharge their responsibilities effectively, the senior management should, as far as practicable, ensure that the CO and MLRO are:

(a) subject to any constraints, having regard to the size of the practice, independent of operational and business functions;
(b) based in Hong Kong;
(c) of a sufficient level of seniority and authority;
(d) afforded regular contact with, and, when required, direct access to, the senior management to ensure that the senior management are able to satisfy themselves that their statutory obligations are being met and that the business is taking sufficiently robust measures to protect itself against the risks of ML/TF;
(e) fully conversant with the practice's statutory and regulatory requirements and the ML/TF risks arising from the business;
(f) capable of accessing, on a timely basis, all available information (both from internal sources, such as CDD records, and external sources, such as notices and circulars from the Institute); and
(g) equipped with sufficient resources, including staff and appropriate cover for their absence.

Indicative roles of CO and MLRO

610.3.3 The CO would generally act as the focal point within a practice for the oversight of all activities relating to the prevention and detection of ML/TF and providing support and guidance to the senior management to ensure that ML/TF risks are adequately managed. Typically the CO would have responsibility for:

(a) reviewing the practice's AML/CFT systems to ensure they are up to date and meet current statutory and regulatory requirements; and

(b) oversight of the practice's AML/CFT controls, including monitoring their effectiveness and enhancing the controls and procedures where necessary.

610.3.4 Areas which may be considered by the CO, include:

(a) how the AML/CFT controls are to be managed and tested;

(b) identifying and addressing significant deficiencies in the controls;

(c) mitigating ML/TF risks arising from business relationships and transactions with persons from countries that do not apply, or insufficiently apply, the FATFRs;

(d) communicating key AML/CFT issues to the senior management, including, where appropriate, significant compliance deficiencies;

(e) considering changes that may need to be made or proposed as a result of new legislation, regulatory requirements or guidance relevant to AML/CFT;

(f) training of staff for AML/CFT purposes.

610.3.5 The MLRO must play an active role in the identification and reporting of suspicious transactions. The MLRO's principal functions would normally include:

(a) reviewing internal disclosures and exception reports and, in light of available relevant information, determining whether or not it is necessary to make an STR to the **Joint Financial Intelligence Unit** ("JFIU")[6];

(b) maintaining records related to such internal reviews;

(c) providing guidance on how to avoid "tipping off", where disclosures are made; and

(d) acting as the main point of contact with the JFIU, law enforcement, and any other competent authorities in relation to ML/TF prevention and detection, investigation or compliance.

Compliance function

610.3.6 The compliance function of a practice should review the implementation of the AML/CFT controls, (including, the controls for recognising and reporting suspicious transactions), to ensure effectiveness. The frequency and extent of the review should be commensurate with the risks of ML/TF and the size of the practice's business. Where appropriate, practices may engage an external party to conduct the review.

610.3.7 Where practicable, practices should establish an independent compliance function which should have a direct line of communication to the senior management.

Staff screening

610.3.8 Practices should establish, maintain and operate appropriate procedures in order to be satisfied of the integrity of any new employees.

6 JFIU was established in 1989 and is run jointly by the Hong Kong Police Force and Customs and Excise Department. Its role is to receive, analyse and store suspicious transactions reports, and disseminate them to the appropriate investigative units.

610.4 Business conducted outside Hong Kong

610.4.1 Practices with overseas branches/ offices, or subsidiary undertakings, must adopt a group AML/CFT policy to ensure that branches/ offices and subsidiary undertakings that carry on the same business as the practice in a place outside of Hong Kong have procedures in place to comply with CDD and RK requirements, similar to those imposed under Schedule 2 of AMLO, to the extent permitted by the law of that location.

610.4.2 If the law of the place at which a branch/ office, or subsidiary undertaking carries on business does not permit the application of any procedures relating to any of the requirements referred to in 610.4.1, the practice shall (a) inform the Institute and (b) take additional measures to effectively mitigate the risk of ML/TF faced by the branch/ office, or subsidiary undertaking as a result of its inability to comply with the requirements.

SECTION 620

Customer Due Diligence

General requirements

620.1 When carrying out any of the services specified in paragraphs 600.2.1 and 600.2.2, practices must perform the following CDD measures:

(a) identify the client and verify the client's identity using documents, data or information provided by a government body or other reliable, independent source;

(b) where there is a beneficial owner[7] in relation to the client (subject to certain limited exceptions indicated below) identify and take reasonable measures to verify the beneficial owner's identity, so that the practice is satisfied that it knows who the beneficial owner is, including in the case of a legal person or trust[8], measures to enable the practice to understand the ownership and control structure of the legal person or trust;

(c) understand and, as appropriate, obtain information on the purpose and intended nature of the business relationship (if any) to be established with the practice, unless the purpose and intended nature are obvious; and

(d) if a person purports to act on behalf of the client:
(i) identify the person and take reasonable measures to verify the person's identity using documents, data or information provided by a government body or other reliable and independent source;
(ii) verify the person's authority to act on behalf of the client; and

Practices must adopt enhanced due diligence measures in relation to high-risk clients (including foreign "politically exposed persons" or "PEPs"), and may adopt simplified due diligence measures in certain specified circumstances.

620.2 Introduction to CDD

620.2.1 CDD information is an important element in recognising whether there are grounds for knowledge or suspicion of ML/TF. It is intended to enable practices to form a reasonable belief that they know the true identity of each client and, with an appropriate degree of confidence, know the type of business and transactions that the client is likely to undertake and the source and intended use of funds.

620.2.2 Practices must, therefore, identify, and verify the identity of their clients, to the extent necessary to provide them with reasonable assurance that the information they have is an appropriate and sufficient indication of the client's true identity. In general, a standard level of due diligence should be applied to all clients, with the possibility to carry out simplified CDD ("SDD") in lower-risk scenarios. In contrast, enhanced CDD ("EDD") must be applied in respect of clients or circumstances determined to be of higher ML/TF risk.

620.2.3 Practices may have other client acceptance and continuance procedures, for example, to ensure compliance with independence requirements and to avoid conflicts of interest.

7 For definitions, see Appendix E.

8 For the purpose of these Guidelines, a trust means an express trust or any similar arrangement for which a legally-binding document (i.e., a trust deed or in any other form) is in place.

The CDD may either be integrated with those procedures or addressed separately. Initial CDD information assists in client acceptance decisions and also enables practices to form expectations of their client's behaviour, which provides some assistance on detecting potentially suspicious behaviour during the business relationship.

620.2.4 In determining what constitutes "reasonable measures" to verify the identity of a beneficial owner and understand the ownership and control structure of a legal person or trust, and/or to verify the identity of a person who purports to act on behalf of a client, practices should consider and give due regard to the ML/TF risks posed by a particular client and a particular business relationship. Examples of possible risk factors are set out in Appendix B.

620.3 Circumstances where CDD should be applied

620.3.1 CDD requirements must generally be applied:
(a) before establishing a business relationship with a client;
(b) before carrying out for the client an occasional transaction involving an amount equal to or above HK$120,000 or an equivalent amount in any other currency, whether the transaction is carried out in a single operation or in several operations that appear to be linked;
(c) where there may be a suspicion of ML/TF; or
(d) when there is doubt about the veracity or adequacy of any information previously obtained for the purpose of identifying the client or verifying the client's identity.

Pre-existing clients

620.3.2 Practices must perform the CDD measures set out in these Guidelines in respect of pre-existing clients (with whom the business relationship was established before the Guidelines came into effect), in addition to the situations in paragraph 620.3.1 (c) and (d):
(a) when a transaction takes place with regard to the client, which is:
(i) by virtue of the amount or nature of the transaction, unusual or suspicious;
(ii) not consistent with the practice's knowledge of the client or the client's business or risk profile, or with its knowledge of the source of the client's funds; or
(b) when a material change occurs in the way in which the client's business in conducted.

620.3.3 Practices should, in any case, over time, review the information known about pre-existing clients, assess the ML/TF risks of such clients and seek more information if necessary. Requirements for ongoing monitoring also apply to pre-existing clients (see Section 630).

620.3.4 If a practice is unable to comply with paragraph 620.3.2, AMLO[9] requires that the business relationship with the client be terminated as soon as practicable.

620.4 Client acceptance/risk assessment and risk categories

620.4.1 Practices should assess the ML/TF risks of individual clients when evaluating their clients during the acceptance stage and when taking on new engagements for pre-existing clients.

620.4.2 While a risk assessment should always be performed at the inception of a client relationship, for some clients, a comprehensive risk profile may only become evident once the service has begun, making ongoing monitoring a fundamental component of a reasonably designed RBA. Practices may therefore have to adjust their risk assessment

9 See AMLO, Schedule 2, section 6(2)

of a particular client from time to time, or based upon information received, and review the extent and frequency of the CDD and ongoing monitoring to be applied to the client.

620.4.3 While there is no agreed upon definitive set of risk factors and no one methodology to apply these risk factors in determining the ML/TF risk rating of clients, as indicated in Appendix B, relevant factors can, generally speaking, be organised into three broad categories, which, in practice, are often inter-related, namely, client risk, country or geographic risk, and service, including delivery channel, risk.

620.4.4 Factors that may indicate a higher level of client risk include:

(a) Indications that the client is attempting to obscure understanding of its business, ownership or the nature of its transactions
(b) Indications of certain transactions, structures, geographical locations, international activities, or other factors, that are not in keeping with the practice's understanding of the client's business or economic situation
(c) Client industries, sectors or categories where opportunities for ML/TF are particularly prevalent.

620.4.5 However, not all clients falling into such risk categories are necessarily high-risk clients. After adequate review, it may be determined that a particular client is pursuing a legitimate purpose. Provided the economic rationale for the structure and/or activities or transactions of a client can be made clear, if called upon to do so, a practice may be able to demonstrate that the client is carrying out legitimate operations for which there is a satisfactory explanation and non-criminal purpose.

620.4.6 As regards country or geographic risk, this, in conjunction with other risk factors, may provide useful information as to potential ML/TF risks. Clients may be judged to pose a higher than normal risk where they, or their source or destination of funds, are located in a country that is, e.g., subject to sanctions, identified by the FATF, or other credible sources, as lacking an appropriate AML/CFT regime, or identified by credible sources as having significant level of corruption or providing support to terrorists or terrorist activities.

620.4.7 A balanced and common sense approach should be adopted with regard to clients connected with jurisdictions which do not, or which insufficiently, apply the FATF recommendations (see paragraphs 620.12.22-620.12.25). While extra care may be justified in such cases, it is not a requirement to refuse to do any business with such clients or automatically to classify them as high risk and subject them to an EDD process. Rather, practices should weigh all the circumstances of the particular situation and assess whether there is a higher than normal risk of ML/TF.

620.5 Identification and verification of the client's identity

620.5.1 Practices must identify the customer and verify the client's identity by reference to documents, data or information provided by a reliable and independent source, such as a governmental body, public register, or other source generally recognised as being reliable and independent. Copies of all reference source documents, data or information used to verify the identity of the client should be retained (see Section 660). Where the client is unable to produce original documents, practices may consider accepting documents that are certified to be true copies by an independent, qualified person (see paragraph 620.12.4-620.12.5).

620.5.2 Appendix C contains further information on documents generally recognised as appropriate, independent and reliable sources for the purposes of verifying the identity of natural persons, legal persons and trusts.

620.6 Identification and verification of a beneficial owner

620.6.1 A beneficial owner is normally an individual, or individuals, who ultimately own or control the client, or on whose behalf a service is being provided. For a client who is an individual, not acting in an official capacity on behalf of a legal person or trust, the client him/herself is normally the beneficial owner. There is no requirement to make proactive searches for beneficial owners in such a case, but practices should make appropriate enquiries where there are indications that the client is not acting on his/her own behalf.

620.6.2 Where an individual is identified as a beneficial owner, practices should endeavour to obtain identification information of the kind set out in Part I of Appendix C.

620.6.3 Generally, however, the verification requirements are different for a client and a beneficial owner. The obligation to verify the identity of a beneficial owner is to take reasonable measures, based on an assessment of the ML/TF risks, so that the practice is satisfied that it knows who the beneficial owner is.

620.6.4 Practices should identify all beneficial owners of a client. A beneficial owner in relation to a corporation is an individual who owns or controls, directly or indirectly, more than 25% of the issued share capital or voting rights, or who exercises ultimate control over the management, of the corporation. If the corporation is acting on behalf of another person, reference to "beneficial owner" means that other person. There are equivalent definitions for the beneficial owner of a partnership or trust (see Appendix E).

620.7 Identification and verification of a person purporting to act on behalf of the client

620.7.1 If a person purports to act on behalf of the client, practices must:

(a) identify the person and take reasonable measures to verify the person's identity on the basis of documents, data or information provided by-
  (i) a governmental body;
  (ii) any other source generally recognised as being reliable and independent
(b) verify the person's authority to act on behalf of the client.

620.7.2 In taking reasonable measures to verify the identity of persons purporting to act on behalf of clients (e.g., authorised account signatories and attorneys), practices should endeavour to obtain the same kind of identification information as that set out in Appendix C.

620.7.3 Practices should also obtain written authority[10] verifying that the individual purporting to represent the client is authorised to do so.

620.8 Characteristics and evidence of identity

620.8.1 If suspicions are raised in relation to the veracity any document offered, practices should take practical and proportionate steps to establish whether the document offered is genuine, or has been reported as lost or stolen (e.g., searching publicly-available information, approaching relevant authorities or requesting corroboratory evidence from the client. Where suspicion cannot be eliminated, the document should not be accepted and consideration should be given to making an STR.

620.8.2 Where documents are in a foreign language, practice should take appropriate steps to be reasonably satisfied that the documents provide evidence of the client's identity.

[10] For a corporation, the board resolution or similar written authority should be obtained.

620.9 Purpose and intended nature of business relationship

620.9.1 Unless the purpose and intended nature are obvious, practices must obtain information from all new clients to satisfy themselves as to the intended purpose and reason for establishing the relationship, and document the information. Depending on the practice's risk assessment of the situation, relevant information may include:

(a) nature and details of the business/occupation/employment;
(b) the anticipated level and nature of the activity that is to be undertaken through the relationship (e.g., the services that are likely to be required);
(c) location of client;
(d) the expected source and origin of any funds to be used in the relationship; and
(e) initial and ongoing source(s) of wealth or income.

620.10 Timing of identification and verification of identity

General requirement

620.10.1 Generally, the CDD process, i.e., obtaining information on the client and beneficial owners, and about the purpose and intended nature of the business relationship, must be completed before establishing any client relationship and/or before carrying out occasional transactions or assignments, other than in exceptional cases, as set out in 620.10.3.

620.10.2 In normal circumstances, where practices are unable to complete the CDD process as indicated above, they must not establish a client relationship or carry out any occasional transactions or assignments with that client. They should also assess whether this failure, in itself, provides grounds for knowledge or suspicion of ML/TF and making a report to the JFIU.

Delayed client identity verification and failure to complete verification

620.10.3 Exceptionally, practices may verify the identity of the client and, to the extent necessary, any beneficial owner, after establishing the business relationship, provided that:

(a) any risk of ML/TF arising from the delayed verification of the client's or beneficial owner's identity can be effectively managed; and
(b) it is necessary not to interrupt the normal course of business with the client;

620.10.4 This discretion must not be used to defer CDD procedures unnecessarily, in particular, where:

(a) there may be some indications of ML/TF;
(b) practices become aware of anything that gives rise to doubt the identity or intentions of the client or beneficial owner; or
(c) the relationship is assessed to pose a higher risk.

620.10.5 Verification of identity must be concluded within a reasonable timeframe thereafter. Where this cannot be done, practices shall as soon as reasonably practicable suspend or terminate the service or relationship, unless there is a reasonable explanation for the delay[11].

620.10.6 Practices should assess whether a failure to complete the desired verification of itself provides grounds for knowledge or suspicion of ML/TF and for making an STR to the

[11] For reference only, the Hong Kong Monetary Authority specifies the following timeframes:
(a) completing such verification no later than 30 working days after the establishment of business relations;
(b) suspending business relations with the client and refraining from carrying out further activities or transactions (except, where relevant, to return funds to their sources, to the extent that this is possible) if such verification remains uncompleted 30 working days after the establishment of business relations; and
(c) terminating business relations with the client if such verification remains uncompleted 120 working days after the establishment of business relations.

JFIU.

Keeping client information up-to-date

620.10.7 Once the identity of a client has been satisfactorily verified, there is no obligation to re-verify identity (unless doubts arise as to the veracity or adequacy of the evidence previously obtained). However, steps should be taken from time to time to ensure that the client information obtained for the purposes of CDD is up to date and relevant, by undertaking periodic reviews of existing records of clients. An appropriate time to do so is upon certain trigger events such as when:

(a) a significant or unusual activity or transaction is to take place[12];
(b) a material change occurs in the client's ownership and/or activities – practices are advised to consider at least annually whether there have been changes suggesting that a full reappraisal would be sensible[13];
(c) a practice's client documentation standards change substantially; or
(d) a practice is aware that it lacks sufficient information about the client concerned.

In all cases, the factors determining the period of review or what constitutes a trigger event should be set out in the practice's policies and procedures. (See also Section 630 of these Guidelines.)

620.10.8 All clients assessed as high risk should be subject to an ongoing review of their profile to ensure the CDD information retained on them remains up to date and relevant. It would be prudent to review the risk category of other clients at least on an annual basis.

620.11 Application of simplified client due diligence

When SDD can be conducted generally

620.11.1 Where the risks of ML/TF are lower, practices may perform SDD measures, which take into account the nature of the lower risk. The simplified measures should be commensurate with the lower risk factors (e.g., a lower risk for identification and verification purpose at the client acceptance stage does not automatically mean that the same client is lower risk at the ongoing monitoring stage). Examples of possible SDD measures are:

(a) Verifying the identity of the client and the beneficial owner after the establishment of the business relationship.
(b) In some circumstances, not trying to identify the beneficial owner (see paragraph 620.11.6).
(c) Reducing the frequency of client identification updates.
(d) Reducing the degree of ongoing monitoring and scrutinising of activities.
(e) Not collecting specific information to understand the purpose and intended nature of the business relationship, but inferring the purpose and nature from the type of transactions or business relationship established.

620.11.2 SDD measures shall not be adopted whenever there may be a suspicion of ML/TF, when a practice doubts the veracity or adequacy of any client identification/ verification information previously obtained, even though the client or the activity may fall within the scope of paragraphs 620.11.5, 620.11.9 and 620.1.10 below, or where specific higher-risk scenarios apply, e.g., where the client is from, or based in, a higher-risk country or jurisdiction.

620.11.3 Practices should set out in their internal procedures what is considered to constitute reasonable grounds to conclude that a client can be subject to SDD measures. Where

---

12 "Significant" is not necessarily linked to monetary value. It may include activities that are unusual or not in line with the practice's knowledge of the client.

13 Reference should also be made to AMLO Schedule 2, section 6.

SDD is performed, the grounds for and details of the risk assessment, and the nature of the SDD measures, should be documented. Practices may have to substantiate these grounds to the Institute or other relevant authorities.

620.11.4 The following are some examples where SDD measures may be adopted:
(a) Reliable information on the client is publicly available.
(b) The practice is familiar with the client's AML/CFT controls due to previous dealings with the client.
(c) The client is a listed company that is subject to regulatory disclosure requirements, or an FI that is subject to and supervised for compliance with AML/CFT requirements consistent with standards set by the FATF.

Specific types of client to which SDD may be applied

620.11.5 AMLO indicates that it is not necessary to identify and verify the identity of any beneficial owner, in the circumstances set out in paragraph 620.3.1(a) or (b), where the client is:
(a) a Hong Kong SAR Government entity or a public body in Hong Kong;
(b) a government or public body in an equivalent jurisdiction (see subsection 620.15);
(c) a corporation listed on a stock exchange;
(d) an FI, as defined in AMLO;
(e) an institution incorporated or established in an equivalent jurisdiction which carries on a business similar to an FI, is subject to AML/CFT requirements consistent with standards set by the FATF and is supervised for compliance with those requirements by an authority in that jurisdiction that performs functions similar to a relevant authority[14];
(f) an investment vehicle where the person responsible for carrying out the CDD-related measures in relation to all the investors of the investment vehicle is-
(i) an FI;
(ii) an institution incorporated or established in Hong Kong, or in an equivalent jurisdiction, which has measures in place to ensure compliance with requirements similar to those imposed under Schedule 2 of AMLO, and is supervised for compliance with those requirements.

620.11.6 If a client not falling within paragraph 620.11.5 has in its ownership chain an entity falling within the scope of that paragraph, it is not necessary to identify or verify the beneficial owners of that entity or of any person in that chain beyond that entity, in the circumstances referred to in paragraph 620.3.1(a) or (b).

Foreign financial institutions

620.11.7 For ascertaining whether an institution meets the criteria set out in paragraph 620.11.5(f) it will generally be sufficient for practices to verify that the institution is on the list of authorised (and supervised) FIs in the jurisdiction concerned.

Listed companies

620.11.8 For relevant listed companies, it will be generally sufficient for practices to obtain proof of listed status on a stock exchange. In other cases, practices should endeavour to obtain the identification information for a legal person of the kind set out in Appendix C.

Government and public bodies

620.11.9 Public body includes:
(a) any executive, legislative, municipal or urban council;

14 I.e., the regulators of relevant FIs in Hong Kong

(b) any government department or undertaking;
(c) any local or public authority or undertaking;
(d) any board, commission, committee or other body, whether paid or unpaid, appointed by the Chief Executive of the Hong Kong SAR or the government; and
(e) any board, commission, committee or other body that has power to act in a public capacity under or for the purposes of any enactment.

SDD in relation to specific products

620.11.10 It is not necessary to identify and verify the identity of any beneficial owner of the client, in the circumstances referred to in paragraph 620.3.1(a) or (b), if the practice has reasonable grounds to believe that the product to which the transaction relates is:
(a) a provident, pension, retirement or superannuation scheme (however described) that provides retirement benefits to employees, where contributions to the scheme are made by way of deduction from income from employment and the scheme rules do not permit the assignment of a member's interest under the scheme; or
(b) an insurance policy of the kind stipulated in Schedule 2, section 4(5) of AMLO.

Solicitor's client accounts

620.11.11 If a client of a practice is a solicitor or a firm of solicitors, the practice is not required to identify any beneficial owner of the customer account opened by the practice's client in the circumstances referred to in paragraph 620.3.1(a) or (b), provided that the following criteria are satisfied:
(a) the customer account is kept in the name of the practice's client ;
(b) moneys or securities of the client's customers in the client account are mingled; and
(c) the client account is managed by the client as agent of those customers.

620.12 Application of enhanced client due diligence

High-risk situations

620.12.1 In situations that, by their nature, present a higher risk of ML/TF, practices must carry out additional measures or EDD[15] to mitigate the risk of ML/TF. (Examples of possible risk factors are indicated in Appendix B.) Depending upon whether the business relationship is to be or has been established, EDD must include:
(a) obtaining the approval of the senior management to commence or continue the relationship, as applicable; and
(b) taking reasonable measures to establish the relevant client's or beneficial owner's source of wealth and of the funds that are or will be involved in the business relationship, or other additional mitigation measures, e.g.:
  (i) obtaining additional information on the intended nature of the business relationship (e.g., anticipated account activity);
  (ii) obtaining additional information on the client (e.g., connected parties[16], accounts or relationships) and updating the client profile more regularly;
  (iii) conducting enhanced monitoring of the business relationship, by increasing the number and timing of the controls applied and selecting patterns of transactions that need further examination.

Client not physically present for identification purposes

620.12.2 Practices must apply equally effective client identification procedures and ongoing

15 Additional measures should be documented in the practice's policies and procedures.

16 Consideration may be given to obtaining, and taking reasonable measures to verify, the addresses of directors and account signatories.

monitoring standards for clients not physically present for identification purposes as for those where the client is available for interview[17]. Where a client has not been physically present for identification purposes, practices will generally not be able to determine that the documentary evidence of identity actually relates to the client they are dealing with. Consequently, there are increased risks and practices must carry out at least one of the following measures to mitigate the risks posed:

(a) further verifying the client's identity on the basis of documents, data or information referred to in paragraph 620.5, but not previously used for the purposes of verifying the client's identity;
(b) taking supplementary measures to verify the information relating to the client that has been obtained by the practice.

620.12.3 Consideration should be given on the basis of the ML/TF risk to obtaining copies of documents that have been certified by a suitable certifier.

Suitable certifiers and the certification procedure

620.12.4 Use of an independent suitable certifier guards against the risk that documentation provided does not correspond to the client whose identity is being verified. However, for certification to be effective, the certifier will need to have seen the original documentation. Suitable persons to certify verification of identity documents may include:

(a) an intermediary specified in paragraphs 620.13.7-620.13.9;
(b) a member of the judiciary in an equivalent jurisdiction;
(c) an officer of an embassy, consulate or high commission of the country of issue of documentary verification of identity; and
(d) a Justice of the Peace.

620.12.5 Practices should exercise caution when considering accepting certified copy documents, especially where such documents originate from a country perceived to represent a high risk, or from unregulated entities in any jurisdiction.

Politically exposed persons

General

620.12.6 Much international attention has been paid in recent years to the risks associated with providing financial and business services to those with a prominent political profile or holding senior public office because their office and position may render such PEPs vulnerable to corruption. The risks increase when the person concerned is from a foreign country with widely-known problems of bribery, corruption and financial irregularity within their governments and society, particularly where such countries do not have adequate AML/CFT standards.

620.12.7 While the statutory definition of PEPs in AMLO (see paragraph 620.12.9) includes only individuals entrusted with a prominent public function in a place outside the People's Republic of China[18], domestic PEPs may also present, by virtue of the positions they hold, a high risk situation in which EDD should be applied. Practices should therefore adopt an RBA in determining whether to also apply the measures in paragraph 620.12.14 to domestic PEPs.

620.12.8 The statutory definition does not automatically exclude sub-national political figures. In determining what constitutes a prominent public function, practices should consider

[17] This is not restricted to being physically present in Hong Kong; a face-to face meeting could take place outside Hong Kong.

[18] Under the Interpretation and General Clauses Ordinance (Cap. 1), the definition of the People's Republic of China includes Hong Kong, Taiwan and Macau.

factors such as persons with significant influence in general, significant influence over or control of public procurement, state-owned enterprises, etc.

(Foreign) PEPs

620.12.9 A PEP is defined in AMLO as:

(a) an individual who is or has been entrusted with a prominent public function in a place outside the People's Republic of China, and
    (i) includes a head of state, head of government, senior politician, senior government, judicial or military official, senior executive of a state-owned corporation and an important political party official;
    (ii) but does not include a middle-ranking or more junior official of any of the categories mentioned in subparagraph (i);
(b) a spouse, a partner, a child or a parent of an individual falling within paragraph (a) above, or a spouse or a partner of a child of such an individual; or
(c) a close associate of an individual falling within paragraph (a).

620.12.10 AMLO defines a "close associate" as:

(a) an individual who has close business relations with a person falling under paragraph 620.12.9(a) above, including an individual who is a beneficial owner of a legal person or trust of which the relevant person is also a beneficial owner; or
(b) an individual who is the beneficial owner of a legal person or trust that is set up for the benefit of a person falling under paragraph 620.12.9(a).

620.12.11 Practices should establish and maintain effective procedures for determining whether a client or a beneficial owner of a client is a PEP. Risk can be reduced by conducting EDD before establishing the business relationship and ongoing monitoring where the practice knows or suspects that the client relationship is with, or involves, a PEP.

620.12.12 Practices may use publicly-available information and/or screening against commercially available databases, or refer to relevant reports and databases on corruption risk published by specialised national, international, non-governmental and commercial organisations to assess which countries are most vulnerable to corruption (e.g., Transparency International's "Corruption Perceptions Index") and should be vigilant where either the country to which the client has business connections, or the business/ industrial sector, is more vulnerable to corruption.

620.12.13 Specific risk factors practices should consider in handling a business relationship (or potential relationship) with a PEP include:

(a) any particular concern over the country where the PEP holds his/her public office or has been entrusted with his/her public functions, taking into account his position;
(b) any unexplained sources of wealth or income (i.e., value of assets owned not in line with the PEP's income level);
(c) expected receipts of large sums from governmental bodies or state-owned entities;
(d) source of wealth described as commission earned on government contracts;
(e) request by the PEP to associate any form of secrecy with a transaction; and
(f) use of government accounts as the source of funds in a transaction.

620.12.14 When practices know that a particular client or beneficial owner is a PEP, before establishing a business relationship, or continuing an existing business relationship, where the client or the beneficial owner is subsequently found to be a PEP, they must apply the following EDD measures:

(a) obtain approval from the senior management;
(b) take reasonable measures to establish the client's or the beneficial owner's source of wealth and the source of the funds involved in the business

relationship; and

(c) if a practice proceeds to establish a relationship or to continue an existing relationship, it should apply enhanced monitoring to the relationship in accordance with the assessed risks.

620.12.15 It is for practices to decide the measures they deem reasonable to establish the source of funds and wealth, in accordance with their assessment of the risks,.

Domestic PEPs

620.12.16 For the purposes of these Guidelines, a domestic PEP is defined as:

(a) an individual who is or has been entrusted with a prominent public function in a place within the People's Republic of China, and
  (i) includes a head of state, head of government, senior politician, senior government, judicial or military official, senior executive of a state-owned corporation and an important political party official;
  (ii) but does not include a middle-ranking or more junior official of any of the categories mentioned in subparagraph (i);

(b) a spouse, a partner, a child or a parent of an individual falling within paragraph (a) above, or a spouse or a partner of a child of such an individual; or

(c) a close associate of an individual falling within paragraph (a) (see paragraph 620.12.10).

620.12.17 Practices must take reasonable measures to determine whether an individual is a domestic PEP. If an individual is known to be a domestic PEP, a practice must perform a risk assessment to determine whether the individual poses a higher risk of ML/TF. Domestic PEP status in itself does not automatically confer higher risk. In any situation that a practice assesses to present a higher risk of ML/TF, it must apply the EDD and monitoring referred to in paragraph 620.12.14.

620.12.18 Practices should retain a copy of the assessment and should review the assessment whenever concerns as to the activities of the individual arise.

Senior management approval

620.12.19 As regards the level of management personnel who may approve the establishment or continuation of a relationship where EDD applies, the approval process should take into account the advice of a practice's CO, where one has been appointed. In general the more potentially sensitive the PEP, the higher the approval process should be escalated.

Periodic reviews

620.12.20 Foreign PEPs, and also domestic PEPs assessed to present a higher ML/TF risk, must be subject to a minimum annual review. CDD information should be reviewed to ensure that it remains up to date and relevant.

Bearer shares

620.12.21 Bearer shares lack the regulation and control of common shares because ownership is not recorded. Therefore, if practices come across companies with capital in the form of bearer shares, they should adopt procedures to establish the identities of the holders and beneficial owners of such shares and ensure that they are notified whenever there is a change of holder or beneficial owner.

Jurisdictions that do not apply, or insufficiently apply, the FATFRs, or otherwise posing higher ML/TF risk

620.12.22 Practices should give particular attention to, and exercise extra care in respect of:
(a) client relationships with, and the provision of ad hoc services to, persons (including legal persons and FIs) from or in jurisdictions that do not apply, or which insufficiently apply, the FATFRs; and
(b) transactions and businesses connected with jurisdictions assessed as higher ML/TF risk.

620.12.23 In determining which jurisdictions either do not apply, or insufficiently apply, the FATFRs, or which may otherwise pose a higher risk, practices should consider, among other things:
(a) information that may be issued by the Institute from time to time (see paragraph 620.12.25);
(b) whether the jurisdiction is subject to sanctions, embargoes or similar measures imposed by, for example, the Security Council of the United Nations ("UN Security Council")(see Section 650);
(c) whether the jurisdiction is identified by credible sources as lacking appropriate AML/CFT laws, regulations and other measures[19];
(d) whether the jurisdiction is identified by credible sources as providing funding or support for terrorist activities or has designated terrorist organisations operating within it; and
(e) whether the jurisdiction is identified by credible sources as having significant levels of corruption, or other criminal activity.

620.12.24 Practices should be aware of the potential reputational risk of conducting business in jurisdictions that do not apply, or insufficiently apply, the FATFRs, or other jurisdictions known to apply inferior standards for the prevention of ML/TF. If practices established in Hong Kong have office in such jurisdictions, practices should ensure that the controls adopted in such overseas units are, as far as possible, similar to those adopted in Hong Kong.

620.12.25 Where the requirement is called for by the FATF, or in other circumstances independent of the FATF, but also considered to be higher risk, the Institute may advise practices to undertake EDD measures, proportionate to the nature of the risks.

620.13 Reliance on CDD performed by intermediaries

General

620.13.1 Practices may rely upon an intermediary to perform any part of the CDD measures specified in subsection 620.1, subject to confirming that the intermediary has adequate AML/ CFT controls in place and the other considerations set out in this section. However, the ultimate responsibility for ensuring that CDD requirements are met remains with practices.

620.13.2 Reliance on third parties may occur through, e.g., introductions made by another member of the same network or referrals from other practices or other professionals.

620.13.3 Written confirmation shall be obtained from the intermediary that:

[19] "Credible sources" refers to information that is produced by well-known bodies generally regarded as reputable, which make such information publicly and widely available. In addition to the FATF and FATF-style regional bodies, such sources may include, but are not limited to, supra-national or international bodies such as the International Monetary Fund, and the Egmont Group of Financial Intelligence Units, as well as relevant national government bodies and non-government organisations. The information provided by these credible sources does not have the effect of law or regulation and should not be viewed as an automatic determination that something is of higher risk.

(a) it agrees to perform the role; and
(b) it will provide without delay a copy of any document or record obtained in the course of carrying out the CDD measures on behalf of the practice, upon request.

620.13.4 Practices should obtain satisfactory evidence to confirm the status and eligibility of the intermediary. Such evidence may comprise evidence from the intermediary of its status, regulation, policies and procedures.

620.13.5 Practices that carry out a CDD measure by means of an intermediary must as soon as possible after the intermediary has carried out that measure, obtain from the intermediary the data or information that the intermediary has obtained in the course of carrying out that measure. This does not require obtaining at the same time a copy of the document, or a record of the data or information, that is obtained by the intermediary.

620.13.6 Where these documents and records are kept by the intermediary, practice must obtain an undertaking from the intermediary to keep all underlying CDD information throughout the continuance of the practice's business relationship with the client and for at least five years beginning on the date on which the relationship of the client with the practice ends. An undertaking must also be obtained from the intermediary to supply copies of all underlying CDD information where the intermediary is about to cease trading or will no longer continue to act as an intermediary for the practice.

Domestic intermediaries

620.13.7 Practices may rely upon the following to perform any part of the CDD measures:
(a) certain types of FIs, as specified in AMLO, Schedule 2, section 18(3)(b) (i.e., an authorised institution, a licensed corporation, an authorised insurer, an appointed insurance agent or an authorised insurance broker); or
(b) a DNFBP, provided that the intermediary is able to satisfy the practice it has adequate procedures in place to prevent ML/TF.

Overseas intermediaries

620.13.8 Practices may rely upon an overseas intermediary carrying on business or practising in an equivalent jurisdiction to perform any part of the CDD measures, only where the intermediary:
(a) falls into one of the following categories of businesses or professions:
  (i) an institution that carries on in the jurisdiction a business similar to those referred to in paragraph 620.13.7(a);
  (ii) a lawyer, a notary public; an auditor, a professional accountant, a trust or company service provider, or a tax adviser practising in the jurisdiction;
  (iii) a trust company carrying on trust business in the jurisdiction;
  (iv) a person who carries on in the jurisdiction a business similar to that carried on by an estate agent; and
(b) is required under the law of the jurisdiction concerned to be registered or licensed or is regulated under the law of that jurisdiction;
(c) has measures in place to ensure compliance with CDD and RK requirements similar to those under Schedule 2 of AMLO, and is supervised for compliance with those requirements by an authority in that jurisdiction similar to any of the relevant authorities or regulatory bodies (as applicable) in Hong Kong.

620.14 Prohibition on anonymous accounts

620.14.1 Practices should not assist new or existing clients to open or maintain anonymous accounts or accounts in fictitious names.

620.15 Jurisdictional equivalence

Determination of jurisdictional equivalence

620.15.1 Jurisdictional equivalence is an important aspect in the application of CDD measures above. "Equivalent jurisdiction" is defined in AMLO as meaning:

(a) a jurisdiction that is a member of the FATF (other than Hong Kong); or

(b) a jurisdiction that imposes requirements similar to those imposed under Schedule 2 of AMLO.

620.15.2 Practices may, therefore, need to consider which jurisdictions, other than FATF members, apply requirements similar to those imposed under Schedule 2 of AMLO (or these Guidelines) for jurisdictional equivalence purposes. When doing so practices should document their assessment, which may include consideration of the following positive or negative factors:

(a) membership of a regional group of jurisdictions that admit jurisdictions that have demonstrated a commitment to combating ML/TF, and which have appropriate legal and regulatory regimes;

(b) mutual evaluation reports undertaken by the FATF, FATF-style regional bodies, the International Monetary Fund and the World Bank, etc., bearing in mind that mutual evaluation reports are at a “point in time”;

(c) lists of jurisdictions published by the FATF with strategic AML/CFT deficiencies;

(d) information that may be circulated by the Institute from time to time alerting practices to jurisdictions regarded as having poor AML/CFT controls;

(e) lists of jurisdictions, entities and individuals that are involved, or that are alleged to be involved, in activities that cast doubt on their integrity in relation to AML/CFT, published by specialised national, international, non-governmental and commercial organisations (e.g., Transparency International’s "Corruption Perceptions Index"; and

(f) guidance provided at paragraph 620.12.25.

SECTION 630

Ongoing Monitoring

General requirements

630.1 Effective ongoing monitoring is vital for understanding of clients' business and an integral part of effective AML/CFT controls. It helps practices to know their clients and to detect unusual or suspicious transactions.

630.1.1 **When carrying out any of the services specified in paragraphs 600.1.2 and 600.2.2, practices shall monitor their business relationships with clients by:**

(a) reviewing from time to time documents, data and information relating to the client, obtained by the practice for the purposes of complying with AMLO, to ensure that they are up to date and relevant;

(b) paying attention to transactions carried out for the client to ensure that they are consistent with the practice's knowledge of the client and the client's nature of business, risk profile and source of funds. An unusual activity may be in the form of one that is inconsistent with the expected pattern for that client, or with the normal business activities for the type of product or service that is being delivered; and

(c) identifying transactions that are complex, involve unusually large sums of money, or unusual patterns of activity, which have no apparent economic or lawful purpose, examining the background and purposes of those transactions and recording their findings in writing.

630.1.2 A failure to conduct proper ongoing monitoring could expose practices to potential abuse by criminals, and may call into question the adequacy of controls, or the prudence and integrity of a practice's management.

630.1.3 Possible characteristics practices should consider monitoring include:
(a) the nature and type of activities (e.g., abnormal amounts or frequency);
(b) the nature of a series of transactions;
(c) the amount of any transactions, paying particular attention to particularly substantial transactions;
(d) the geographical origin/destination of a payment or receipt; and
(e) the client's normal activity or turnover.

630.1.4 Practices should be vigilant for significant changes in relation to the basis of the business relationship with the client over time. These may include where:
(a) new products or services that pose higher risk are introduced;
(b) new corporate or trust structures are created;
(c) the stated activity or turnover of a client changes or increases; or
(d) the nature, frequency or size of activities changes, etc.

630.1.5 Where transactions are complex, involve unusually large sums of money, or unusual patterns of activity, and have no apparent economic or lawful purpose, practices must examine the background and purpose, including, where appropriate, the circumstances, of the transactions. The findings of these examinations must be properly documented in writing. Proper records of decisions made, by whom, and the rationale for them will help to demonstrate that a practice is handling unusual or suspicious activities appropriately.

630.1.6 Where the basis of the business relationship changes significantly, practices should carry out further CDD procedures to ensure that the ML/TF risk involved and basis of the relationship are fully understood. Ongoing monitoring procedures should take account of the above changes.

630.2 Risk-based approach in relation to monitoring

630.2.1 The extent of monitoring should be linked to the risk profile of the client, determined through the risk assessment. To be most effective, resources should be targeted towards business relationships presenting a higher risk of ML/TF. At the same time practices should also periodically review the risk profile of their clients generally as part of their ongoing monitoring, and may need to re-categorise individual clients, as appropriate.

630.2.2 Practices must take additional measures, such as conducting more frequent reviews, when monitoring relationships that are assessed as posing a higher risk, e.g., where:

(a) a client has not been physically present for identification purposes; or

(b) a client, or a beneficial owner of a client is known to the practice, from public information or information in its possession, to be a PEP.

Pre-existing clients

630.2.3 In relation to pre-existing clients, when practices perform ongoing monitoring before they first carrying out CDD measures in relation to the client, under AMLO, practices are required only to review the documents, data and information relating to the client that are held by them at the time that they conduct the review.

SECTION 640

Making Suspicious Transaction Reports

General requirements[20]

640.1 DTROP and OSCO (section 25A) require a person to report if he/she knows or suspects any property to be the proceeds of drug trafficking or an indictable offence, respectively. UNATMO (section 12(1)) requires a person to report if he/she knows or suspects that any property is terrorist property.

640.1.1 **Once knowledge or suspicion of an ML/TF transaction or activity has been established, the following general requirements apply:**

(a) Practices must make a report to an authorised officer[21] even where no service has been provided by the practice[22] A member working in a practice may discharge his/her responsibility by making a report to the MLRO designated by his/her employer;

(b) the report must be made as soon as is reasonably practical after the suspicion or knowledge is first established; and

(c) practices must ensure that they have in place internal controls to prevent any partner, director, or employee committing the offence of "tipping off" the client, or any other person who is the subject of the report. Practices should also take care that their line of enquiry with the client is such that tipping off cannot be construed to have taken place.

Under Hong Kong laws, the requirement to make suspicious transaction reports is not limited to any particular services or situations and, therefore, it applies to all services provided by practices.

640.2 Legal requirements in relation to making suspicious transaction reports

640.2.1 Under sections 25A(1) of DTROP/ OSCO, a person must make a disclosure to an authorised officer as soon as it is reasonable for him/her to do so, if he/she knows or suspects that any property:

(a) in whole or in part, directly or indirectly, represents the proceeds of[23];
(b) was used in connection with; or
(c) is intended to be used in connection with,

drug trafficking/ an indictable offence/.

---

20 See also the Institute's **frequently-asked questions on suspicious transaction reporting**.

21 See Footnote 1.

22 The reporting obligations of section 25A(1) DTROP/OSCO and section 12(1) UNATMO apply to “any property” and require a person to report suspicions of ML/TF, irrespective of the amount involved. These provisions establish a reporting obligation whenever a suspicion arises, without reference to transactions *per se.* Thus, the obligation to report applies whether or not a transaction was actually conducted and also covers attempted transactions.

23 DTROP/OSCO, section 25A(1).

640.2.2 Under section 12(1) of UNATMO, where a person knows or suspects that any property is terrorist property, the person must disclose to an authorised officer the information or other matter:
(a) on which the knowledge or suspicion is based; and
(b) as soon as is practicable after that information or other matter comes to the person's attention.

640.2.3 It is an offence under section 25A of DTROP/OSCO and section 14(5) of UNATMO, carrying a maximum penalty of three months imprisonment and a fine at **level 5**[24], to fail to make a disclosure to an authorised officer where a person has the requisite knowledge or suspicion.

640.2.4 Once an employee has reported his/her suspicion to an appropriate person (see Section 2 on the appointment and roles of an MLRO) and in accordance with the procedure established by his/her employer for the making of such disclosures, he/she has fully satisfied the statutory obligation[25].

640.2.5 Filing an STR to the JFIU provides a statutory defence to the offence of ML/TF in respect of the acts disclosed in the report, provided:
(a) the STR is made before a person undertakes the disclosed acts and the acts are undertaken with the consent of the JFIU; or
(b) the STR is made after a person has performed the disclosed acts and the report is made on the person's own initiative and as soon as it is reasonable for the person to do so[26].

640.2.6 A disclosure under section 25A of DTROP/OSCO or section 12 of UNATMO will not be a breach of contract, enactment, rule of conduct, or provision restricting disclosure of information. The person making the disclosure will not be liable in damages for loss arising out of the disclosure[27].

(See Appendix A for further information on DTROP, OSCO and UNATMO)

640.2.7 CDD and ongoing monitoring provide the basis for recognising unusual and suspicious transactions and events. The key is to know enough about a client's business to recognise that an activity or transaction, or a series of transactions, is unusual and, from an examination of the unusual, to be able to conclude whether there is a suspicion of ML/TF.

640.2.8 Practices must ensure members of staff are made aware of their statutory obligations and that sufficient guidance and training are provided to enable them to recognise when ML/TF may be taking place[28]. Staff also need to be sensitive to the risk of tipping off during their client work (see paragraphs 640.2.16-640.2.21).

640.2.9 For a person to have knowledge or suspicion, he/she does not need to know the nature of the criminal activity underlying the ML, or that the proceeds themselves have definitely arisen from the criminal offence.

640.2.10 General suspicious transactions indicators and further examples of situations that could give rise to suspicions are provided in Appendix D. The examples are not intended to be exhaustive and are only indications of the most basic ways in which money may be laundered. However, identification of any of the circumstances similar to those listed in

---

24 Standard levels of fines under various ordinances are specified in Schedule 8, Criminal Procedure Ordinance.

25 DTROP/OSCO, section 25A(4); UNATMO, section 12(4)

26 DTROP/OSCO, section 25A(2); UNATMO, section 12(2).

27 DTROP/OSCO, section 25A(3); UNATMO section 12(3).

28 See Section 8 of these Guidelines for further information on staff hiring and training.

Appendix D, may prompt further investigations and, at least, be a trigger for making initial enquiries about the source of funds and the nature of the client's activities.

640.2.11 Practices should also be aware of elements of individual transactions that could indicate property involved in TF. The FATF has issued **Guidance for Financial Institutions in Detecting Terrorist Financing**, which may also be a useful reference for practices.

Timing and manner of reports

640.2.12 In making STRs to the JFIU, the use of a standard form or the use of the e-channel "STREAMS"[29] by registered users is encouraged by the JFIU. Further details of reporting methods and advice may be found on the JFIU website. In the event that an STR is urgent, particularly when the matter is part of an ongoing investigation, this should be indicated in the STR. Where exceptional circumstances exist in relation to an urgent STR, an immediate notification to the JFIU by telephone would be desirable.

640.2.13 Depending on when knowledge or suspicion arises, an STR may be made either before a suspicious transaction or activity occurs (whether the intended transaction ultimately takes place or not), or after a transaction or activity has been completed.

640.2.14 The law requires the STR to be made together with any matter on which the knowledge or suspicion is based. The need for prompt disclosures is especially important where a client has instructed a practice to move funds or other property, make cash available for collection, or carry out significant changes to the business relationship. In such circumstances, an urgent notification to the JFIU by telephone would be desirable.

640.2.15 Knowledge or suspicion that any property represents the proceeds of an indictable offence should normally be reported within the jurisdiction where the knowledge or suspicion arises and where the records of the related activities are held. However, in certain cases, e.g., when there is a very clear nexus with Hong Kong, even though the knowledge or suspicion may arise outside Hong Kong, reporting to the JFIU may be required, but only if section 25A of DTROP/OSCO applies[30].

Tipping off

640.2.16 A person commits an offence of "tipping off", under DTROP/OSCO or UNATMO[31], if, knowing or suspecting that an STR has been made, he/she discloses to any other person any matter that is likely to prejudice an investigation that might be conducted following the original disclosure. An offence of tipping off carries a maximum penalty, upon conviction, of imprisonment for three years and a fine of $500,000.

640.2.17 A risk exists that clients could be unintentionally tipped off when practices are seeking to extend their CDD obligations during the establishment or course of the business relationship, or when conducting occasional or ad hoc transactions or services. If further enquiries of a client become necessary, where it is known or suspected that an STR has already been made, the client should not be made aware that relevant agencies have been alerted about his/her name.

640.2.18 A client's awareness of a possible STR or investigation could prejudice future efforts to investigate the suspected ML/TF operation. Therefore, if practices form a suspicion that

---

29 STREAMS (Suspicion Transaction Report and Management System) is a web-based platform to assist in the receipt, analysis and dissemination of STRs. Use of STREAMS is recommended, especially for practices which make frequent reports. Further details may be obtained from the JFIU.

30 Section 25(4) of OSCO stipulates that an indictable offence includes conduct outside Hong Kong which would constitute an indictable offence if it had occurred in Hong Kong. Therefore, where a practice in Hong Kong has information regarding ML/TF, irrespective of the location, it should consider seeking clarification from and making a report to the JFIU.

31 DTROP/OSCO section 25A(5); UNATMO section 12(5)

activities or transactions relate to ML/TF, they should take into account the risk of tipping off when completing the CDD process. Practices shall ensure that their employees are aware of and sensitive to these issues when conducting CDD.

640.2.19 A person cannot be held liable for a tipping-off offence unless that person knows or suspects that an STR has been made, either internally or to the JFIU, or alternatively knows or suspects that the law enforcement agencies are conducting or intending to conduct an ML/TF investigation in relation to the persons or entities concerned.

640.2.20 Therefore, unless a staff member making enquiries has knowledge or suspicion of a current or impending investigation, where a practice is seeking additional information during preliminary enquiries of a prospective client, this should not give rise to a tipping-off offence. However, if the enquiries lead to a subsequent report being made, then the client shall not be informed or alerted.

640.2.21 It is a defence that it was not known or suspected that the disclosure was likely to prejudice an investigation. Therefore, where a practice communicates suspicions of ML/TF activities to a client's senior management, internal auditors, or other person responsible for monitoring, or reporting, ML/TF, the practice should first be satisfied, as far as possible, that:

(a) the persons to whom it is communicating its suspicions are not implicated in the suspected ML/TF; and
(b) the information communicated will not be passed to others who may prejudice the investigation or proposed investigation.

640.3 Internal reporting and recording

640.3.1 As indicated in Section 2, practices must appoint an MLRO as a central reference point for reporting suspicious transactions. The MLRO should:

(a) be responsible for making STRs to the JFIU;
(b) keep a register of all reports made to him/her by employees, and by the practice to the JFIU;
(c) on request by the employee concerned, provide a written acknowledgement of a report made to him/her by an employee; and
(d) it is also advisable for the MLRO to keep a record of discussions relating to internal reports.

640.3.2 Where staff members working in a practice have knowledge or suspicion of matters referred to in paragraphs 640.2.1 or 640.2.2, they should inform the MLRO, regardless of whether they believe an STR has already been made by another person to the JFIU or other authorities.

640.3.3 The MLRO should consider all internal disclosures he/she receives in the light of full access to all relevant documentation and other parties. He/she should play an active role in the identification and reporting of suspicious transactions. The MRLO should promptly evaluate, whether in his/her view, there are suspicious circumstances that would require a report to be made to the JFIU. If there are, the MLRO shall report all relevant details to the JFIU, without undue delay and should co-operate with any resulting JFIU investigation. If, on the other hand, a decision is made not to make an STR, the MRLO must document the reasons.

640.3.4 To enable the MLRO to fulfil his/her functions, practices should ensure that he/she receives full co-operation from all staff and access to all relevant documentation so that the MLRO is in a position to decide whether there is knowledge or suspicion of ML/TF.

640.3.5 When reporting suspicious transactions to the JFIU, sufficient information should be provided, including, e.g., the following details, as applicable[32]:

(a) personal particulars of the person or company involved, e.g., name, identity card or passport number, date of birth, address, telephone number, and bank account number;
(b) details of the suspicious transaction;
(c) the reason why the transaction is suspicious, i.e., which suspicious activity indicators are present;
(d) the explanation, if any, given by the person or company about the transaction.

640.3.6 To assist the disclosure of all relevant information, JFIU have provided **a form** on its website. An STR to the JFIU can be made through STREAMS, by email, fax, mail or telephone.

640.3.7 Practices must establish and maintain procedures to ensure that:

(a) staff are made aware of the identity of the MLRO and of the procedures to follow when making an internal disclosure report; and
(b) disclosure reports reach the MLRO without undue delay.

640.3.8 While practices may allow staff members to consult with supervisors or managers before deciding whether to draw up a report to the MLRO, in the normal course of events, any report raised by staff should not be filtered out by supervisors or managers who have no responsibility for the ML reporting/ compliance function. The legal obligation is to report as soon as it is reasonable to do so, so reporting lines should be as short as possible with the minimum number of people between the staff with the suspicion and the MLRO. This ensures speed, confidentiality and accessibility to the MLRO.

640.3.9 All suspicious activities reported to the MLRO must be documented (in urgent cases this may follow an initial discussion by telephone). The report should include the full details of the client and as full a statement as possible of the information giving rise to the suspicion.

640.3.10 The MLRO should acknowledge receipt of the report and at the same time provide a reminder of the obligation to avoid tipping off. The tipping-off obligation includes circumstances where a suspicion has been raised internally, but has not yet been reported to the JFIU.

640.3.11 The reporting of a suspicion in respect of a transaction or event does not remove the need to report further suspicious transactions or events in respect of the same client. Further suspicious transactions or events, whether of the same nature or different to the previous suspicion, must continue to be reported to the MLRO, who must make further reports to the JFIU, if appropriate.

640.3.12 When evaluating an internal report, the MLRO should take reasonable steps to consider all relevant information, including CDD and ongoing monitoring information available within or to the practice concerning the entity or entities to which the report relates. This may include:

(a) reviewing of other transaction patterns and volumes through connected accounts;
(b) reviewing any previous patterns of instructions, the length of the business relationship and reference to CDD and ongoing monitoring information and documentation; and
(c) appropriate questioning of the client (e.g., as suggested in the systematic

32 See the JFIU website: https://www.jfiu.gov.hk/en/str_main.html.

approach to identifying suspicious transactions recommended by the JFIU[33]).

640.3.13 As part of the review, other clients and/or services may need to be examined. The need to search for information concerning, e.g., connected relationships should strike an appropriate balance between the statutory requirement to make a timely STR to the JFIU and any delays that might arise in searching for more relevant information concerning connected accounts or relationships. The evaluation process, along with any conclusions drawn, should be documented.

640.3.14 If, after completing the evaluation, the MLRO decides that there are grounds for knowledge or suspicion, he/she must disclose the information to the JFIU, together with the information on which that knowledge or suspicion is based, as soon as it is reasonable to do so after his/her evaluation is complete. Providing the MLRO acts conscientiously and in good faith, there should not be any issue of failing to report where he/she concludes that there is no suspicion, after taking into account all available information. It is however essential for MLROs to keep proper records of their deliberations and actions taken to demonstrate that they have acted reasonably. The MLRO may wish to obtain legal advice, as necessary.

640.3.15 In relation to section 25A(2) of DTROP/OSCO and section 12(2) of UNATMO, a member who has made a report should, where appropriate, seek permission from the JFIU to continue to perform his/her duties in relation to the client. Where applicable, such consent should be sought through the MLRO.

640.3.16 In certain circumstances, it may not be feasible to curtail a service that is known, or suspected, to be related to ML/TF, before informing the JFIU, or to do so would likely frustrate efforts to pursue the beneficiaries of a suspected ML/TF operation. Where possible, the MLRO should, nevertheless, be alerted to the situation.

640.3.17 It is not an offence where a person, prior to making an STR, deals with property which he knows, or has reasonable grounds to believe, represents the proceeds of an indictable offence, provided that a disclosure is made on his/her own initiative, as soon as reasonable after performing the act (see paragraph 640.2.5).

640.3.18 While a practice may consider communicating its suspicions to a client's regulator if this is permitted and appropriate, this is not a substitute for reporting to the JFIU.

640.3.19 A practice may wish to terminate its relationship with a client that is being, or is likely to be, investigated. However, before terminating a relationship, the practice should consider liaising with the JFIU, or the investigation officer, to ensure that the termination does not tip off the client, or prejudice the investigation. In more complex situations, a practice may also wish to take legal advice on the implications of termination under the terms of the contract.

640.3.20 Practices should note that the statutory duty to make STRs, where applicable, overrides the duty of confidentiality owed to clients and, as indicated above (see paragraph 640.2.6), a disclosure made to the JFIU will be not be a breach of contract, enactment, rule of conduct or provision restricting the disclosure of information. The person who made it will not be liable in damages for loss arising out of the disclosure. At the same time it should be noted that this protection extends only to the disclosure of knowledge or suspicion of ML/TF, and any matter on which that knowledge or suspicion is based. STRs should be made in good faith and based on genuine knowledge or suspicion. If in doubt, practices should consider seeking legal advice before making a disclosure.

---

33 For details, see: **https://www.jfiu.gov.hk/en/str_ask.html**

Recording internal reports and reports to the JFIU

640.3.21 Practices must establish and maintain a record of all ML/TF reports made to the MLRO. The record should include details of the date that the report was made, the staff members subsequently handling the report, the results of the assessment, whether the report resulted in a disclosure to the JFIU, and information to allow the papers relevant to the report to be located.

640.3.22 Practices must also establish and maintain a record of all STRs made to the JFIU. The record should include details of the date of the STR, the person who made the report, and information to allow the papers relevant to the STR to be located. This record may be combined with the record of internal reports, if considered appropriate.

640.4 Post-reporting matters

640.4.1 Practices should note the following:

(a) Filing an STR to the JFIU provides a statutory defence to ML/TF only in relation to the acts disclosed in that particular report. It does not absolve practices from the legal, reputational or regulatory risks associated with the continuing assignment or client relationship;

(b) a "consent" response from the JFIU to a pre-transaction STR should not be construed as a "clean bill of health" for the continuing assignment or client relationship, or an indication that the assignment or relationship does not pose a risk to the practice;

(c) practices should conduct an appropriate review of a business relationship upon the filing of an STR to the JFIU, irrespective of any subsequent feedback provided by the JFIU;

(d) once practices have concerns about an assignment or a client relationship, they should take appropriate action to mitigate the risks. Filing an STR with the JFIU and continuing with the assignment or relationship, without any further consideration of the risks and the imposition of appropriate controls to mitigate the risks identified, would not be a sufficient response;

(e) relationships reported to the JFIU should be subject to an appropriate review by the MLRO and, if necessary, the issue should be escalated to the practice's senior management to determine how to handle the relationship, in order to mitigate any potential legal or reputational risks, in line with the practice's business objectives, and its capacity to mitigate the risks identified; and

(f) practices are not obliged to continue specific assignments and/or client relationships if such action would place them at risk. It is recommended to indicate any intention to terminate an assignment or relationship in the initial STR to the JFIU, thereby allowing the JFIU to comment, at an early stage, on such a course of action.

640.4.2 The Institute understands that the JFIU will acknowledge receipt of an STR made under section 25A of DTROP/OSCO or section 12 of UNATMO. If there is no need for imminent action, consent will usually be given in writing for the practice to continue with the relevant activity or transaction, under the provisions of section 25A(2) of DTROP/OSCO. For STRs submitted via "STREAMS", an e-receipt will be issued via the same channel. The JFIU may, on occasion, seek additional information or clarification of matters on which the knowledge or suspicion is based.

640.4.3 Whilst there is no statutory requirement to provide feedback arising from investigations, the JFIU provides feedback in its quarterly report[34] and, the Institute also understands, upon request, to a disclosing practice in relation to the current status of the investigation.

[34] The purpose of the quarterly report, which is relevant to all financial sectors, is to raise AML/CFT awareness. It consists of two parts, (i) analysis of STRs and (ii) matters of interest and feedback. The report is available through the JFIU's website at **www.jfiu.gov.hk.** A password is required. Details may be found under the typologies and feedback section of the website or by contacting the JFIU directly.

640.4.4 After initial analysis by the JFIU, STRs that are to be pursued are allocated to financial investigation officers for further investigation. Practices should respond to production orders within the required time limits and provide the information or material that falls within the scope of such orders. Where a practice encounters difficulty in complying with the timeframes stipulated, the MLRO should at the earliest opportunity contact the officer-in-charge of the investigation for further guidance.

640.4.5 Upon the conviction of a defendant, a court may order the confiscation of relevant criminal proceeds and a practice may be served with a Confiscation Order, in the event that it holds property belonging to that defendant that is deemed by the courts to represent a benefit from the crime. A court may also order the forfeiture of property where it is satisfied that the property is a terrorist property.

640.5 Organisations other than member practices

640.5.1 Members working in organisations other than practices should ascertain whether their employers have procedures for making STRs through a CO/ MLRO. As indicated above, employees who make reports in accordance with procedures laid down by their employers are regarded as complying with the relevant laws[35]. In the absence of any employer's procedures, STRs would need to be made direct to the JFIU.

640.5.2 Members working in the banking, insurance and securities industries are advised to familiarise themselves with AMLO and guidelines on AML/CFT issued by the relevant financial services regulator. It should be noted that, under AMLO, it is a criminal offence if a person who is an employee of an FI or is employed to work for an FI, or is concerned in the management of an FI, (i) knowingly, or (ii) with intent to defraud the FI or any relevant authority, causes or permits the FI to contravene a specified provision of AMLO. The maximum penalty upon conviction on indictment, in the case of (i), is imprisonment for two years and fine of $1 million and, in the case of (ii), imprisonment for seven years and fine of $1 million[36].

[35] See Footnote 26.

[36] AMLO, section 5.

SECTION 650

Financial Sanctions and Terrorist Financing

General requirements

650.1 In relation to targeted financial sanctions and the financing of terrorism/ proliferation of weapons of mass destruction, practices must take note of and comply with their legal obligations, which include considering the need to make STRs.

650.1.1 Targeted financial sanctions are a specific type of sanctions decided by the UN Security Council for freezing funds, financial assets and economic resources owned or controlled, directly or indirectly, by designated individuals or entities and for preventing funds, financial assets or economic resources from being made available to such individuals and entities. Practices may refer to sanctions lists maintained by the UN Security Council and its Sanctions Committees. The lists are available on the webpages of the **relevant committees**.

650.1.2 The United Nations Sanctions Ordinance (Cap. 537) ("UNSO") empowers the Chief Executive of the Hong Kong SAR to make regulations to implement sanctions decided by the UN Security Council, including targeted financial sanctions against individuals or entities designated by the UN Security Council or its committees. Designated individuals and entities are specified by notice published in the Gazette.

650.1.3 Under the regulations made under the UNSO, it is an offence to make available any funds or other financial assets or economic resources to, or for the benefit of, such designated person or entity, as well as those acting on their behalves, at their direction, or owned or controlled by them; or to deal with any funds, other financial assets or economic resources belonging to, or owned or controlled by, such persons and entities, except under the authority of a licence granted by the Chief Executive. Offenders are subject to a maximum sentence of 7 years' imprisonment and an unlimited amount of fine. These prohibitions are relevant not only to FIs, but also to DNFBPs, including accountants, and practices must take steps to keep themselves informed of the current list of designated individuals and entities. For enquiries about licence applications, practices should approach the Commerce and Economic Development Bureau.

650.1.4 The Institute may inform members from time to time of designations published in the Government Gazette pursuant to regulations made under the UNSO.

650.1.5 Practices should conduct name checks of their clients and their beneficial owners against the latest lists of the designated individuals and entities. Practices should report to the Institute any actions taken in compliance with the targeted financial sanctions, including attempted transactions.

650.1.6 While practices will not normally have any obligation under Hong Kong laws to have regard to lists issued by organisations or authorities in other jurisdictions, practices with overseas offices may need to be aware of the scope and focus of relevant sanctions regimes in those jurisdictions.

Terrorist financing

650.1.7 TF generally refers to the carrying out of transactions involving property owned by terrorists, or that has been, or is intended to be, used to assist the commission of terrorist acts. Initially, this was not part of the AML regime, but subsequently the AML framework was expanded to include special recommendations on TF. With ML, the focus is on the handling of criminal proceeds, i.e., the source of property is what matters.

With TF, however, the focus is on the destination or use of property, which may have originated from legitimate sources.

650.1.8 The UN Security Council passed UN Security Council Resolution (UNSCR) 1373 (2001), which calls on all member states to act to prevent and suppress the financing of terrorist acts. The **UN Counter Terrorism Committee** has issued relevant guidance in relation to the implementation of UNSCRs.

650.1.9 UN has also published the names of individuals and organisations subject to UN financial sanctions in relation to involvement with ISIL (Da'esh), Al-Qa'ida, and the Taliban under relevant UNSCRs (e.g., UNSCR 1267 (1999), 1989 (2011) and 2253 (2015)). All UN member states are required under international law to freeze the funds and economic resources of any legal persons named in this list and to report any suspected name matches to the relevant authorities.

650.1.10 UNATMO was enacted in 2002 to give effect to the mandatory elements of UNSCR 1373 and the FATFRs relating to TF.

650.1.11 The Secretary for Security of the Hong Kong SAR ("S for S") has the power to freeze suspected terrorist property and may direct that a person must not deal with the frozen property except under the authority of a licence. Contraventions are subject to a maximum penalty of seven years imprisonment and an unspecified fine.

650.1.12 Section 8 of UNATMO does not affect a freeze per se; it prohibits a person from (i) making available any property or financial services to, or for the benefit of, a person he/she knows, or has reasonable grounds to suspect, is a terrorist or terrorist associate, in the absence of a licence granted by S for S; and (ii) collecting property or soliciting financial (or related) services for the benefit of a person he/she knows, or has reasonable grounds to suspect, is a terrorist or terrorist associate. Contraventions are subject to a maximum sentence of 14 years imprisonment and an unspecified fine.

650.1.13 S for S can license exceptions to the prohibitions to enable frozen property and economic resources to be unfrozen and to allow payments to be made to, or for the benefit of, a designated party under UNATMO.

650.1.14 Where a person is designated by a committee of the UN Security Council as a terrorist, generally, that person's details will subsequently be published in a notice under section 4 of UNATMO in the Government Gazette.

650.1.15 For lists of designated persons, reference may be made to various sources, including relevant designations by overseas authorities, such as the designations made by the US Government under relevant Executive Orders. The Institute may draw practices' attention to such designations from time to time.

650.1.16 Practices must have controls in place to conduct checks against relevant lists of terrorists, etc., for screening purposes and must take reasonable steps to ensure that their sources of information are up to date.

Proliferation of weapons of mass destruction

650.1.17 Under the Weapons of Mass Destruction (Control of Provision of Services) Ordinance (Cap. 526), it is an offence for a person to provide any services where that person believes or suspects, on reasonable grounds, that those services may be connected to weapons of mass destruction proliferation in or outside Hong Kong. The provision of services is widely defined and includes the lending of money or other provision of financial assistance as well as the provision of professional services.

650.2 Database maintenance and screening (clients and payments)

650.2.1 Practices must establish CFT policies and procedures and take measures to ensure compliance with the relevant regulations and legislation on TF. Staff must be made aware of their legal obligations and suitable guidance and training should be provided to them. The controls for identification of suspicious transactions must cover TF as well as ML.

650.2.2 It is important that practices should be able to identify and report transactions with terrorist suspects and designated parties. They should, therefore, consider maintaining a list or database of names and particulars of terrorist suspects and designated parties, which consolidates the various lists that have been made known to them, or making arrangements to access lists or databases maintained by third party service providers.

650.2.3 Practices should ensure that the relevant designations are included on any list or in any database that they maintain. It should, in particular, include the lists published in the Government Gazette and those designated under the US Executive Order 13224. It should also be subject to timely updating when there are changes, and made easily accessible by staff for the purpose of identifying suspicious transactions.

650.2.4 Ongoing screening by practices of their complete client base is an important part of the internal controls to prevent TF and sanction violations, and may be achieved by:

(a) screening clients against current terrorist and sanction designations at the establishment of the relationship; and

(b) as soon as practicable after new terrorist and sanction designations are made known, or come to the attention of a practice, ensuring that these new designations are screened against a practice's client base.

650.2.5 Where relevant, the screening procedures should extend to the connected parties of the client using an RBA.

650.2.6 Enhanced checks should be conducted before establishing a business relationship or processing a transaction, where possible, if there are circumstances giving rise to suspicion.

650.2.7 In order to be able to demonstrate compliance with the provisions of this section, the screening and any results must be documented or recorded electronically.

650.2.8 If practices suspect that an activity or transaction is terrorist related, they must make an STR to the JFIU. Even if there is no evidence of a direct terrorist connection, the activity or transaction should still be reported to the JFIU if it looks suspicious, as it may emerge subsequently that there is a terrorist link.

650.2.9 The legislation in Hong Kong provides exemptions from civil and criminal liability which applies to practices when sharing third-party information obtained from their clients for the purpose of preventing and suppressing TF. The sharing of information potentially relating to TF is not restricted by the Personal Data Privacy Ordinance (Cap. 486).

650.2.10 Where an STR is made pursuant to paragraph 650.2.8, practices must not disclose to another person any information or matters, which are likely to prejudice the investigation, as tipping off is also an offence under UNATMO.

SECTION 660

RECORD KEEPING

General requirements

660.1 In relation to any of the services specified in paragraphs 600.2.1 and 600.2.2, practices must prepare, maintain and retain documentation and records on their business relations with, and transactions for, clients, as are necessary and sufficient to achieve the record-keeping objectives indicated below and fulfil any related legal or regulatory requirements, and which are appropriate to the scale, nature and complexity of their businesses. The information maintained must be sufficient is to ensure that:

(a) any client and, where appropriate, the beneficial owner of the client, can be properly identified and verified;

(b) the audit trail for particular transactions and properties dealt with by a practice that relates to any client and, where appropriate, the beneficial owner of the client, is clear and complete;

(c) the original or suitable copies of all relevant client and transaction records and information are available on a timely basis to the Institute or other relevant authority, upon appropriate authority; and

(d) practices are able to show evidence of compliance with any relevant requirements specified in other sections of these Guidelines (e.g., relating to client identification, verification and risk assessments, STRs, and staff training).

Records in relation to particular transactions and clients must be retained for at least five years after the transaction has been completed or the business relationship has ended, as applicable.

660.1.1 RK is an essential part of the AML/CFT regime and can facilitate the detection, investigation and confiscation of criminal or terrorist property or funds. RK can help investigating authorities to establish a profile of a suspect and trace criminal or terrorist property or funds. It can assist the court to examine all relevant past businesses activities to assess whether the property or funds are the proceeds of, or relate to, criminal or terrorist offences.

660.1.2 Records must be kept of clients' identity, the supporting evidence of verification of identity (including the original and any updated records), the practice's business relationships with clients (including any non-engagement related documents relating to the client relationship) and details of any occasional transactions and monitoring of the relationship. Historic as well as current records should be retained.

660.1.3 Practices should also store securely information relating to both internal reports received by the MLRO and disclosures to the JFIU. It is also advisable that evidence of assessments of the training needs of staff and steps taken to meet those needs be retained.

660.2 Retention of records relating to client identity and business relationships

660.2.1 Practices must keep:

(a) the original or a copy of the documents, and a record of the data and information, obtained in the course of identifying and verifying the identity of clients, beneficial owners of the client, beneficiaries and persons who purport to act on behalf of the client, and other connected parties of the client;

(b) any additional information on a client and/or beneficial owner of the client that may be obtained for the purposes of EDD or ongoing monitoring;

(c) where applicable, the original or a copy of the documents, and a record of the data and information, on the purpose and intended nature of the business relationship;

(d) the original or a copy of business correspondence[37] with the client and any beneficial owner of the client (which, at a minimum, should include business correspondence material to CDD measures or significant changes to the business relationship or activities);

(e) the original or a copy of the documents, and a record of the data and information, obtained in connection with occasional transactions, which should be sufficient to permit reconstruction of individual transactions or business engagements.

660.2.2 AMLO requires that all relevant documents and records must be kept throughout the business relationship with or transaction for the client and retained for a period of at least five years after the end of the business relationship or transaction, as applicable. Information relating to STRs must also be retained for at least five years after receipt by the MLRO. Staff training records should be retained for a similar period. Either the original document or information, or an electronic copy, should be retained.

660.2.3 As practices need to maintain records for a wide range of purposes to comply with legal and professional requirements for the retention of documentation, the general documentation retention systems employed within the practice may be sufficient, provided that they are of an adequate scope and standard.

660.2.4 Records of internal reports are not considered to form part of client assignment working papers, and so it is advisable that such records be kept in a secure form, separately from the practice's normal methods for retaining client work documents. This is to guard against inadvertent disclosure to any party who may have or seek access to the client working paper files, where AML/CFT matters are not relevant to the purpose for which they are examining the file.

660.3 Manner in which records are to be kept

660.3.1 AMLO states that records required to be kept must be kept in the following way[38]:

(a) if the record consists of a document, either (i) the original of the document must be kept; or (ii) a copy of the document must be kept either on microfilm or in the database of a computer;

(b) if the record consists of data or information, a record of the data or information must be kept either on microfilm or in the database of a computer.

660.3.2 Irrespective of where identification and transaction records are held, practices are required to comply with all legal and regulatory requirements in Hong Kong.

---

[37] Practices are not expected to keep each and every piece of correspondence, such as a series of emails with the client; the expectation is that sufficient correspondence is kept to demonstrate compliance with the Guidelines and to enable STRs to be substantiated and effectively followed up.

[38] Schedule 2, section 21

SECTION 670

STAFF HIRING AND TRAINING

GENERAL REQUIREMENTS

670.1 Practices' AML/CTF policies, procedures and controls must cover employee hiring and training.

670.1.1 As indicated in Section 610, the development of internal policies, procedures and controls should include screening procedures to ensure adequate standards when hiring employees. It is in the practices own interest to hire people who are capable of complying with the fundamental principles.

670.1.2 Staff training is an important element of an effective system to prevent and detect ML/TF activities. The effective implementation of even a well-designed internal control system can be compromised if staff members using the system are not adequately trained.

670.1.3 Practices must provide appropriate AML/CFT training to their staff and should have a clear and well-articulated policy for ensuring that relevant members of staff receive adequate AML/CFT training.

670.1.4 The timing and content of training for different groups of staff may be adapted by practices for their own needs, with due consideration given to the size and complexity of their business and the type and level of ML/TF risk. The frequency of training should be sufficient to ensure that members of staff maintain up-to-date AML/CFT knowledge and competence. Staff should be trained in what they need to do to carry out their particular role with respect to AML/CFT. This is especially important before new staff commence work.

670.1.5 Staff members should be made aware of:

(a) The practice's statutory obligations and their own role in relation to AMLO, particularly Schedule 2 of AMLO;
(b) the practice's and their own statutory obligations to report suspicious transactions under DTROP, OSCO and UNATMO, and the possible consequences of breaches of those obligations;
(c) other statutory and regulatory obligations in respect of AML/CFT under DTROP, OSCO, UNATMO, and UNSO that may concern the practice and themselves, and the possible consequences of breaches of those obligations;
(d) the practice's controls (policies and procedures) relating to AML/CFT, including suspicious transaction identification and reporting; and
(e) new and emerging techniques, methods, trends, etc. in ML/TF, to the extent that such information is needed by the staff to carry out their particular roles in the practice with respect to AML/CFT.

670.1.6 Depending on the seniority and nature of work of different groups of staff, training should include:

(a) an introduction of the background to ML/TF;
(b) the need to identify and report suspicious transactions to the MLRO, and information on the offence of "tipping off";
(c) training in circumstances that may give rise to suspicion, and relevant policies and procedures, including, for example, lines of reporting and when extra vigilance might be required (e.g., circumstances requiring EDD);
(d) appropriate training on client verification and relevant processing procedures.

670.1.7 COs and other managerial staff, including internal audit, where applicable, may require additional, higher-level training covering:

(a) all aspects of the practice's AML/CFT regime;
(b) the practice's controls (policies and procedures) in relation to CDD and RK requirements that are relevant to their job responsibilities;
(c) specific training in relation to their responsibilities for supervising or managing staff, auditing the system and performing random checks, as well as making STRs to the JFIU.

670.1.8 MLROs[39] may require more specific training:

(a) on their responsibilities for assessing reports submitted to them and making STRs to the JFIU; and
(b) to keep abreast of AML/CFT requirements and developments generally.

670.1.9 Practices may consider including available FATF papers and typologies as part of the training materials. All materials should be up to date and in line with current requirements and standards.

670.1.10 Practices must maintain records of staff training (e.g., who has been trained and when, and the type of the training provided).

670.1.11 Practices should monitor the effectiveness of the training. This may be achieved by:

(a) checking staff's understanding of the practice's policies and procedures to combat ML/TF, their understanding of their statutory and regulatory obligations, and also their ability to recognise suspicious transactions and the risks of tipping off; and
(b) monitoring the compliance of staff with the practice's AML/CFT controls, as well as monitoring the quality and quantity of internal reports, so that further training needs may be identified and appropriate action can be taken.

39 As noted in Section 610, in some practices, the CO and the MLRO may be the same person

Appendices A – E

Further information and examples for reference

APPENDIX A

Further information on the Financial Action Task Force, money laundering /terrorist financing and relevant legislation

Background on FATF

1. FATF is an inter-governmental body formed in 1989 that sets the international AML standards. Its mandate was expanded in October 2001 to CFT. In order to ensure full and effective implementation of its standards at the global level, the FATF monitors compliance by conducting evaluations on jurisdictions and undertakes follow-up after the evaluations, including identifying high-risk and uncooperative jurisdictions which could be subject to enhanced scrutiny by the FATF or counter-measures by the FATF members and the international community at large. Many major economies have joined the FATF which has developed into a global network for international cooperation that facilitates exchanges between member jurisdictions.

2. As a member of the FATF, Hong Kong is obliged to implement the AML/CFT requirements as promulgated by the FATF and it is essential that Hong Kong complies with the international AML/CFT standards in order to safeguard its reputation and standing as an international financial centre.

Processes commonly involved in ML

3. There are three common stages in ML, and they frequently involve numerous transactions. These stages are:
   (a) Placement - the physical disposal of cash proceeds derived from illegal activities;
   (b) Layering - separating illicit proceeds from their source by creating complex layers of financial transactions designed to disguise the source of the money, subvert the audit trail and provide anonymity; and
   (c) Integration - creating the impression of apparent legitimacy to criminally derived wealth. In situations where the layering process succeeds, integration schemes effectively return the laundered proceeds back into the general financial system and the proceeds appear to be the result of, or connected to, legitimate business activities.

DTROP and OSCO

4. DTROP, which was introduced in 1989, provides for the tracing, confiscation and recovery of the proceeds of drug trafficking and creates a criminal offence of laundering such proceeds. OSCO was introduced in 1994 and key provisions of it were modelled on DTROP. OSCO extends the scope of the money laundering offences to cover the proceeds of indictable offences generally.

5. Some of the relevant provisions of DTROP and OSCO are summarised below.

Dealing in the proceeds of crime

6. Under section 25 of both DTROP and OSCO, it is a serious offence, carrying a maximum penalty, upon conviction, of 14 years' imprisonment and a fine of five million dollars, to deal with any property, knowing or having reasonable grounds to believe that it, in whole or in part, directly or indirectly, represents the proceeds of an indictable offence. "Dealing" has quite a wide definition, including receiving or acquiring, disguising and disposing of property.

7. As regards the interpretation of "having reasonable grounds to believe", in the case of ***HKSAR v Pang Hung Fai***[40], the Court of Final Appeal ("CFA"), referencing the judgment of the Appeal

[40] Paragraphs 52 and 70 of *HKSAR v Pang Hung Fai* [2014] HKCFA 96*; Seng Yuet Fong v HKSAR* [1999] 2 HKC 833 at 836E-F.

Committee of the CFA, in ***Seng Yuet Fong v HKSAR***, stated: "To convict, the jury had to find that the accused had grounds for believing; and there was the additional requirement that the grounds must be reasonable: That is, that anyone looking at those grounds objectively would so believe."

8. The CFA also considered that the terminology of "subjective" and "objective" tests, which had appeared in decisions following the line of authority from the case of ***HKSAR v Shing Siu Ming & Others***, was unnecessarily complicated and liable to confuse.

9. "Proceeds of an offence" has a broad definition that include payments or rewards, property derived from such payments or rewards, or any financial advantage (which could include, e.g., a cost saving).

10. "Indictable offence" is defined in the Crimes Ordinance (Cap. 200), as "any offence other than an offence which is triable only summarily". This means that an offence that may be tried either summarily or on indictment is regarded as an indictable offence for the purposes of DTROP/ OSCO, and consequently the range of relevant offences is broad. The offences listed in Schedules 1 and 2 of OSCO are examples of indictable offences.

11. Various court decisions have interpreted the offence under section 25 quite widely. For example, it is unnecessary for the prosecution to prove that a specific indictable offence has been committed[41] or to specify an indictable offence in the charge[42].

12. It is a defence to a charge of dealing for a person to prove that, as required under section 25A(1):
    (a) he/she had intended to disclose knowledge or suspicion that property represented the proceeds of, was used or was intended to be used in connection with, an indictable offence, together with any matter on which that knowledge or suspicion was based, to an authorised officer, as soon as it was reasonable for him/her to do so; and
    (b) he/she has a reasonable excuse for his/her failure to make a disclosure.

13. It should be noted that, references to an indictable offence in sections 25 and 25A of DTROP/ OSCO include conduct outside of Hong Kong that would have constituted an indictable offence had it taken place here. Therefore, it may be an offence for a person to deal with criminal proceeds, under section 25(1), or fail to disclose, under section 25A(1), even if the relevant action or crime took place outside Hong Kong. This provision should not be interpreted too narrowly. For example, the evasion of taxes in another jurisdiction may be an indictable offence in this context, even though the specific type of tax in question, e.g., capital gains tax, may not exist in Hong Kong. On the other hand, this does not imply that, ordinarily, a person is expected to know the law of other jurisdictions, or that a person could be in breach of the law in Hong Kong if he acted in a particular way without having such knowledge.

Reporting suspicious transactions

14. As explained in section 640 of these Guidelines, both DTROP and OSCO have requirements, under section 25A, to report suspicious transactions, which apply to everybody in Hong Kong. A person should make a disclosure to an authorised officer as soon as it is reasonable for him/her to do so, if he/she knows or suspects that any property:
    (a) in whole or in part, directly or indirectly, represents the proceeds of an indictable offence;
    (b) was used in connection with an indictable offence; or
    (c) is intended to be used in connection with an indictable offence.

41 *HKSAR v Li Ching* CACC 436/1997; [1997] 4 HKC 108; *HKSAR v Wong Ping Shui & Others* [2000] 1 HKC 600, which was affirmed by the Appeal Committee of the Court of Final Appeal in FAMC 1/2001.

42 *Lam Hei Kit v HKSAR* FAMC 27/2004.

15. "Authorised officer" means[43]:
    (a) any police officer;
    (b) any member of the Customs and Excise Service established by section 3 of the Customs and Excise Service Ordinance (Cap. 342); and
    (c) any other person authorised in writing by the Secretary for Justice for the purposes of this Ordinance.

16. An offence of failing to make a disclosure, in accordance with section 25A, carries a maximum penalty, upon conviction, of imprisonment for three months and a fine at **level 5**.

17. There are other provisions in DTROP/ OSCO, regarding investigation and access to information, of which members may wish to take note.

UNATMO

18. UNATMO is directed primarily towards implementing Resolution 1373 of the United Nations Security Council, dated 28 September 2001, to prevent the financing of terrorist acts. Among other things, it criminalises the supply of funds and making funds, or financial services, available to terrorists or terrorist associates. It permits terrorist property to be frozen and subsequently forfeited.

Reporting under UNATMO

19. UNATMO, which was introduced in 2002, requires a person to report to an authorised officer if he knows or suspects that any property is terrorist property.[44]

20. Relevant definitions under UNATMO include the following:
    "Authorised officer" means[45]:
    (a) a police officer;
    (b) a member of the Customs and Excise Service established by section 3 of the Customs and Excise Service Ordinance (Cap. 342);
    (c) a member of the Immigration Service established by section 3 of the Immigration Service Ordinance (Cap. 311); or
    (d) an officer of the Independent Commission Against Corruption established by section of the Independent Commission Against Corruption Ordinance (Cap. 204).

    "Terrorist property" means:
    (a) the property of a terrorist or terrorist associate; or
    (b) any other property consisting of funds that:
        (i) is intended to be used to finance or otherwise assist the commission of a terrorist act; or
        (ii) was used to finance or otherwise assist the commission of a terrorist act.

    "Terrorist" means a person who commits, or attempts to commit, a terrorist act, or participates in, or facilitates the commission of, a terrorist act.

    "Terrorist act" refers to the use, or threat, of action, where this is intended to:
    (a) cause serious violence against a person;
    (b) cause serious damage to property;
    (c) endanger a person's life, other than that of the person committing the action;
    (d) create serious risk to the health or safety of the public or a section of the public;
    (e) seriously interfere with or seriously disrupt an electronic system; or
    (f) seriously interfere with or seriously disrupt an essential service, facility or system, whether

43 In practice STRs will generally be made to the JFIU, which is a joint unit of the Hong Kong Police Force and Customs and Excise Department.

44 UNATMO, section 12(1).

45 See Footnote 44.

public or private; and

(g) and the use or threat is:

(i) intended to compel the government, or to intimidate the public, or a section of the public; and

(ii) made for the purpose of advancing a political, religious or ideological cause.

(Paragraphs (d), (e) and (f) do not include the use or threat of action in the course of any advocacy, protest, dissent or industrial action.)

"Terrorist associate" means an entity owned or controlled, directly or indirectly, by a Terrorist.

21. Notices of the names of persons designated as terrorists or terrorist associates are published in the Government Gazette, under section 4 of UNATMO, from time to time. The notices reflect designations made by the United Nations Committee pursuant to UNSC Resolution 1267. UNATMO provides that it should be presumed, in the absence of contrary evidence, that a person specified in such notices is a terrorist or a terrorist associate.

Knowledge vs. suspicion

22. There is a statutory obligation to report where there is knowledge or suspicion of ML/TF. Generally speaking, knowledge is likely to include:
(a) actual knowledge;
(b) knowledge of circumstances which would indicate facts to a reasonable person; and
(c) knowledge of circumstances which would put a reasonable person on inquiry.

23. Suspicion, on the other hand, is more subjective. For example, according to the guidance issued by the Consultative Committee of Accountancy Bodies in the United Kingdom[46], in relation to the United Kingdom legislation, having knowledge means actually knowing that something is the case, whereas, suspicion, according to case law, is a state of mind more definite than speculation. While suspicion is personal and falls short of proof based on firm evidence[47], it must be based on some evidence, even if that evidence is tentative.[48]

24. In the case of Queensland Bacon PTY Ltd v Rees[49], it was stated: "…A suspicion that something exists is more than a mere idle wondering whether it exists or not; it is a positive feeling of actual apprehension or mistrust, amounting to a slight opinion, but without sufficient evidence".

25. In the more recent case of **Da Silva**[50], the court stated: "It seems to us that the essential element in the word "suspect" and its affiliates, in this context, is that the defendant must think that there is a possibility, which is more than fanciful, that the relevant facts exist. A vague feeling of unease would not suffice."[51]

Investigations and access to information

26. DTROP, OSCO and UNATMO also contain provisions on investigations and access to information, which include protection for legal privilege.

---

46 The Consultative Committee of Accounting Bodies ("CCAB"), *Anti-money laundering guidance for the accountancy sector*, 2008. (**http://www.ccab.org.uk/PDFs/CCAB%20guidance%202008-8-26.pdf**, paragraph 2.25). See also the revised CCAB guidance, August 2017 (**https://www.ccab.org.uk/documents/TTCCABGuidance2017regsAugdraftforpublication.pdf**, paragraph 6.1.5).

47 Ibid.

48 Ibid., paragraph 2.26.

49 [1966] 115 CLR 266 at 303, per Kitto J

50 Da Silva [2006] EWCA Crim 1654, at16.

51 Ibid.

AMLO

27. AMLO sets out CDD and RK requirements for FIs and DNFBPs and the powers of relevant authorities and regulatory bodies to supervise compliance. It also covers regulation of money services and licensing of money service operators and the licensing of trust or company service providers.

28. Parts 2 and 3 of Schedule 2 cover the specifics of the CDD and RK requirements.

29. Section 7 of AMLO authorises a relevant authority (i.e., primarily the financial service regulators) or regulatory body, which includes the Institute in relation to members and member practices, to publish any guideline that it considers appropriate to provide guidance on the operation of Schedule 2. Under section 7(4), a failure by a person to comply with a guideline in published under section 7 does not, by itself, render the person liable to judicial or other proceedings, but the guideline is admissible in evidence in court proceedings under AMLO, and if any provision of the guideline appears to the court to be relevant to any question arising in the proceedings, the provision must be taken into account in determining that question.

30. Under AMLO, FIs and certain DNFBPs may rely on CDD conducted by some types of intermediary, including certified public accountants practising in Hong Kong, subject to specific conditions. This may be relevant where, for example, an intermediary is introducing or acting on behalf of its client and it could be, for example, an overseas network firm introducing a client to a CPA firm in Hong Kong.

APPENDIX B

Examples of possible risk factors when adopting a risk-based approach

Part I

Client risk

1. It is important to consider who clients are, what they do, and any other information that may suggest the client is of higher risk. Vigilance is required, for example, where the client has a legal form that enables individuals to divest themselves of ownership of property whilst retaining an element of control over it, or to retain anonymity, such as:
   (a) companies that can be incorporated without the identity of the ultimate underlying principals being disclosed;
   (b) certain forms of trusts or foundations, where knowledge of the identity of the true underlying principals or controllers cannot be guaranteed;
   (c) provision for nominee shareholders; and
   (d) companies issuing bearer shares.

2. Risks may be inherent in the nature of the activities of the client and the possibility that the activity, transaction and/or related transaction may itself be criminal, or where the business/industrial sector to which a client has business connections is more vulnerable to corruption For example, the arms trade and the financing of it is a type of activity that poses multiple ML/TF and other risks, e.g.:
   (a) corruption risks arising from procurement contracts;
   (b) risks in relation to PEPs; and
   (c) terrorism and TF risks as shipments may be diverted.

3. Some clients, by their nature or behaviour might present a higher risk of ML/TF. Factors might include:
   - the public profile of the clients indicating involvement with, or connection to, PEPs;
   - complexity of the relationship, including use of corporate structures, trusts and the use of nominee and bearer shares, where there is no clear legitimate commercial rationale;
   - a request to remain anonymous or use undue levels of secrecy with a transaction;
   - involvement in cash-intensive businesses;
   - nature, scope and location of business activities generating the funds/assets, having regard to sensitive or high-risk activities; and
   - where the origin of wealth (for high risk clients and PEPs) or ownership cannot be easily verified.

4. Other general factors that may indicate a higher than normal ML/TF risk in relation to clients include:

   i) <u>Reduced transparency</u>

   - lack of face-to-face introduction of client;
   - subsequent lack of contact, when this would normally be expected;
   - beneficial ownership is unclear;
   - position of intermediaries is unclear;
   - inexplicable changes in ownership;
   - company activities are unclear;
   - legal structure of client has been altered numerous times (name changes, transfer of ownership, change of corporate seat);
   - management appear to be acting according to instructions of unknown or inappropriate person(s);
   - unnecessarily complex client structure;

- reason for client choosing the firm is unclear, given the firm's size, location or specialism;
- frequent or unexplained change of professional adviser(s) or members of management;
- the client is reluctant to provide all the relevant information or the practice has reasonable doubt that the provided information is incorrect or insufficient.

ii) Transactions or structures out of line with business profile

- client instructions or funds outside of their personal or business sector profile;
- individual or classes of transactions that take place outside the established business profile, and expected activities/ transaction;
- employee numbers or structure out of keeping with size or nature of the business (for instance the turnover of a company is unreasonably high considering the number of employees and assets used);
- sudden activity from a previously dormant client;
- client starts or develops an enterprise with unexpected profile or early results;
- indicators that client does not wish to obtain necessary governmental approvals/filings, etc.;
- clients who offer to pay extraordinary fees for services which would not ordinarily warrant such a premium; and
- payments received from unassociated or unknown third parties and payments for fees in cash where this would not be a typical method of payment.

iii) Higher risk sectors and operational structures

- entities with a high level of transactions in cash or readily transferable assets, among which illegitimate funds could be obscured;
- frequent involvement with PEPs;
- investment in real estate at a higher/lower price than expected;
- large international payments with no business rationale;
- unusual financial transactions with unknown source;
- clients with multijurisdictional operations that do not have adequate centralised corporate oversight; and
- clients incorporated in jurisdictions that permit bearer shares.

iv) The existence of fraudulent transactions, or ones which are improperly accounted for, should always be considered suspicious

These might include:
- over and under invoicing of goods/services;
- multiple invoicing of the same goods/services;
- falsely described goods/services – over and under shipments (e.g., false entries on bills of lading); and
- multiple trading of goods/services.

Service risk

5. The characteristics of the services being offered, or intended to be offered, and the extent to which these may be vulnerable to ML/TF abuse, should also be considered. In this connection, it is important to assess the risks of any new services before they are introduced and, where necessary, ensure appropriate additional measures and controls are implemented to mitigate and manage the associated ML/TF risks.

6. Factors presenting higher risk may include services that inherently provide more anonymity. Other services that may be provided by accountants and which (in some circumstances) risk being used to assist money launderers may include:

- misuse of pooled client accounts or safe custody of client money or assets;
- advice on the setting up of legal arrangements, which may be used to obscure ownership or real economic purpose (including setting up of trusts, companies or change of name/corporate seat or other complex group structures);
- misuse of introductory services, e.g. to financial institution.

Country risk[52]

7. Clients with residence in or connection with high-risk jurisdictions; for example countries:

- identified by the FATF or other credible sources as jurisdictions with strategic AML/CFT deficiencies[53];
- subject to sanctions, embargos or similar measures issued by the UN;
- identified by credible sources as having significant levels of corruption, or other criminal activity
- identified by credible sources as providing funding or support for terrorist activities, or that have designated terrorist organisations operating within them.

8. For this purpose, practices may make reference to publicly available information or relevant reports and databases on corruption risk published by specialised national, international, non-governmental and commercial organisations (e.g., Transparency International's "Corruption Perceptions Index", which ranks countries according to their perceived level of corruption).

Delivery channel risk

9. Consider their service delivery channels and the extent to which these may be vulnerable to ML/TF abuse. These may include, for example, delivery where a non-face-to-face approach is used. Services engaged through intermediaries may also increase risk, as the business relationship between the client and a practice may become indirect.

Part II

Variables that may impact on risk

1. Indicated below are some factors that may increase or decrease risk in relation to particular clients, client engagements or practising environments.

- Involvement of financial institutions or other DNFBPs;
- sophistication of client, including complexity of control environment;
- sophistication of transaction/scheme;.
- role or oversight of another regulator;
- the regularity or duration of the relationship. Long-standing relationships involving frequent client contact throughout the relationship may present less risk;
- clients who are employment-based or with a regular source of income from a known legitimate source, which supports the activity being undertaken;

52 In assessing country risk associated with a client, consideration may be given to local legislation (UNSO, UNATMO, etc.), data available from the United Nations, the International Monetary Fund, the World Bank, the FATF, etc. and the practice's own experience or the experience of other group entities (where the practice is part of an international network which may have indicated weaknesses in other jurisdictions).

53 See paragraphs 620.12.22-620.12.25.

- clients who have a reputation for probity in the local communities;
- clients with a sound reputation, e.g., well-known, reputable private companies, with a long history that is well documented by independent sources, including information regarding their ownership and control;
- clarity in terms of the purpose of the relationship and the need for the practice to provide services;
- familiarity with a country, including knowledge of local laws and regulations as well as the structure and extent of regulatory oversight;
- country location of the client; and
- unexplained urgency of assistance required.

APPENDIX C

Examples of sources and content of information for client identification/ verification purposes

Part I

Reliable and independent sources for client identification purposes

1. The identity of an individual physically present in Hong Kong may be verified by reference to their Hong Kong identity card or travel document. Hong Kong residents' identity may be identified and/or verified by reference to their Hong Kong identity card, certificate of identity or document of identity. The identity of non-residents can be verified by reference to their valid travel document.

2. For non-resident individuals who are not physically present in Hong Kong, their identity may be identified and/or verified by reference to the following documents:
   (a) a valid international passport or other travel document; or
   (b) a current national (i.e., government or state-issued) identity card bearing the photograph of the individual; or
   (c) current valid national (i.e., government or state-issued) driving licence incorporating photographic evidence of the identity of the applicant, issued by a competent national or state authority. International drivers' permits and licences are not included for this purpose.

3. "Travel document" means a passport or some other document furnished with a photograph of the holder establishing the identity and nationality, domicile or place of permanent residence of the holder; for example:
   (a) Permanent Resident Identity Card of Macau Special Administrative Region;
   (b) Mainland Travel Permit for Taiwan Residents;
   (c) Seaman's Identity Document (issued under and in accordance with the International Labour Organisation Convention/Seafarers Identity Document Convention 1958);
   (d) Taiwan Travel Permit for Mainland Residents;
   (e) Permit for residents of Macau issued by Director of Immigration;
   (f) Exit-entry Permit for Travelling to and from Hong Kong and Macau for Official Purposes; and
   (g) Exit-entry Permit for Travelling to and from Hong Kong and Macau.

4. A corporate client may be identified and/or verified by performing a company registry search in the place of incorporation and obtaining a full company search report.

5. For jurisdictions that do not have national identity cards and where clients do not have a travel document or driving licence with a photograph, applying an RBA, other documents may be accepted as evidence of identity. Wherever possible such documents should have a photograph of the individual.

Part II

Appropriate identification and verification information

A. Natural persons

Identification

1. Generally, the following identification information should be collected in respect of personal clients who need to be identified:
   (a) full name;
   (b) date of birth;

(c) nationality; and
(d) identity document type and number.

Verification (Hong Kong residents)

2. For Hong Kong permanent residents, an individual's name, date of birth and identity card number may be verified by reference to his/her Hong Kong Identity Card. A copy of the individual's identity card may be retained.

3. For minors born in Hong Kong who are not in possession of a valid travel document or Hong Kong Identity Card[54], their identity may be verified by reference to their Hong Kong birth certificate. Whenever establishing relations with a minor, the identity of the minor's parent or guardian representing or accompanying the minor may also be recorded and verified in accordance with the above requirements.

4. For non-permanent residents, an individual's name, date of birth, nationality and travel document number and type may be verified by reference to a valid travel document (e.g., an unexpired international passport). A copy of the "biodata" page, which contains the bearer's photograph and biographical details, may be retained.

5. Alternatively, an individual's name, date of birth, identity card number may be verified by reference to their Hong Kong identity card, and the individual's nationality by reference to:
(a) a valid travel document;
(b) a relevant national (i.e. government or state-issued) identity card bearing the individual's photograph; or
(c) any government or state-issued document which certifies nationality.

Verification (non-residents)

6. For non-residents who are physically present in Hong Kong for verification purposes, an individual's name, date of birth, nationality and travel document number and type may be verified by reference to a valid travel document (e.g., an unexpired international passport). A copy of the "biodata" page which contains the bearer's photograph and biographical details may be retained.

7. For non-residents who are not physically present in Hong Kong for verification purposes, the individual's identity, including name, date of birth, nationality, identity or travel document number and type may be verified by reference to:
(a) a valid travel document;
(b) a relevant national (i.e. government or state-issued) identity card bearing the individual's photograph;
(c) a valid national driving licence bearing the individual's photograph; or
(d) other suitable alternatives, such as those mentioned in Part I.

8. Where a client has not been physically present for identification purposes, additional measures may need to be carried out (see paragraphs 620.12.2–620.12.3 of these Guidelines).

[54] All residents of Hong Kong who are aged 11 and above are required to register for an identity card. Hong Kong permanent residents will have a Hong Kong Permanent Identity Card. The identity card of a permanent resident (i.e., a Hong Kong Permanent Identity Card) will have on the front of the card a capital letter "A" underneath the individual's date of birth.

Address identification

9. The residential address (and permanent address if different) of a direct client with whom a business relationship is being established may be obtained, as this is useful for verifying an individual's identity and background.

10. It is the trustee of a trust who enters into a business relationship or carries out a transaction on behalf of the trust who will be considered to be the client. The address of the trustee in a direct client relationship may therefore be obtained.

Other considerations

11. The standard identification requirement is likely to be sufficient for most situations. If, however, the client, or the service, is assessed to present a higher ML/TF risk because of the nature of the client, his/her business, his/her location, or because of the product features, etc., it may be considered whether additional identity information may need to be provided, and/or whether to verify additional aspects of identity.

B. Legal persons and trusts

General

1. For legal persons, the principal requirement is to look behind the immediate client to identify those who have ultimate control or ultimate beneficial ownership over the business and the client's assets. Normally particular attention may be paid to persons who exercise ultimate control over the management of the client.

2. The residential address (and permanent address if different) of beneficial owners may be obtained.

3. Where the owner is another legal person or trust, the objective is to undertake reasonable measures to look behind that legal person or trust and to verify the identity of beneficial owners. What constitutes control for this purpose will depend on the nature of the institution, and may vest in those who are mandated to manage funds, accounts or investments without requiring further authorisation.

4. For a client other than a natural person, the client's legal form, structure and ownership should be fully understood and, additionally, information should be obtained on the nature of its business and the reasons for seeking the service, unless the reasons are obvious.

5. Reviews should be conducted from time to time to ensure the client information held is up to date and relevant; methods by which a review could be conducted include conducting company searches, seeking copies of resolutions appointing directors, noting the resignation of directors, or by other appropriate means.

6. Many entities operate internet websites, which contain information about the entity. It should be borne in mind that this information, although helpful in providing much of the materials that might be needed in relation to the client, its management and business, may not be independently verified.

Corporations

Identification information

7. Generally, the information below may be obtained as the standard requirement; thereafter, on the basis of the ML/TF risk, it can be decided whether further verification of identity may be required and, if so, the extent of that further verification. It can also be decided whether additional information in respect of the corporation, its operation and the individuals behind it should be obtained:

(a) full name;
(b) date and place of incorporation;
(c) registration or incorporation number; and
(d) registered office address in the place of incorporation.

If the business address of the client is different from the registered office address in (d) above, information on the business address may be obtained.

8. In the course of verifying the client's information mentioned in paragraph 7, the following information may also be obtained:
(a) a copy of the certificate of incorporation and business registration (where applicable);
(b) a copy of the company's memorandum and articles of association which evidence the powers that regulate and bind the company; and
(c) details of the ownership and structure control of the company (e.g., an ownership chart).

9. The names of all directors[55] may be recorded and their identities verified using an RBA.

10. Where possible, the following may be done:
(a) confirm the company is still registered and has not been dissolved, wound up, suspended or struck off;
(b) independently identify and verify the names of the directors and shareholders recorded in the company registry in the place of incorporation; and
.

11. The information in paragraph 10 above may be verified from:

For a locally-incorporated company -
(a) conducting a file search at the Hong Kong Companies Registry and obtaining a company report[56];

For a company incorporated overseas -
(a) conducting a similar company search enquiry of the registry in the place of incorporation and obtaining a company report;
(b) obtaining a certificate of incumbency[57] or equivalent issued by the company's registered agent in the place of incorporation; or
(c) obtaining a similar or comparable document to a company search report or a certificate of incumbency certified by a professional third party in the relevant jurisdiction, verifying that the information at paragraph 10, contained in the document, is correct and accurate.

12. If, following paragraph 11, a company search report has been obtained, which contains information such as certificate of incorporation, company's memorandum and articles of association, etc, the same information need not be obtained again from the client pursuant to paragraph 8.

---

55 It may, of course, already be required to identify a particular director if the director acts as a beneficial owner or a person purporting to act on behalf of the customer (e.g., account signatories).(see subsections 620.6 and 620.7 of these Guidelines).

56 Alternatively, a certified true copy of a company search report, certified by a company registry or professional third party may be obtained from the client. The company search report should have been issued within the last 6 months. It is not sufficient for the report to be self-certified by the client.

57 A certified true copy of a certificate of incumbency certified by a professional third party may be accepted. The certificate of incumbency should have been issued within the last 6 months. It is not sufficient for the certificate to be self-certified by the client.

C. Beneficial owners

Corporations

1. In relation to beneficial owners of corporations, in normal, non-high risk, situations, AMLO requires verification of the identity of a beneficial owner where that person is:
   (a) an individual who –
      (i) owns or controls, directly or indirectly, including through a trust or bearer shareholding, more than 25% of the issued share capital of the corporation;
      (ii) is, directly or indirectly, entitled to exercise or control the exercise of more than 25% of the voting rights at general meetings of the corporation; or
      (iii) exercises ultimate control over the management of the corporation; or
   (b) if the corporation is acting on behalf of another person, means that other person.

2. The identity of beneficial owners should be identified and recorded, and reasonable measures taken to verify the identity of:
   (a) all shareholders holding more than 25% of the voting rights or share capital;
   (b) any individual who exercises ultimate control over the management of the corporation; and
   (c) any person on whose behalf the client is acting.

3. For companies with multiple layers in their ownership structures, an understanding should be obtained of the ownership and control structure of the company. The intermediate layers of the company should be identified. The manner in which this information is collected should be determined, for example by obtaining a director's declaration incorporating or annexing an ownership chart describing the intermediate layers (the information to be included should be determined on a risk sensitive basis but, at a minimum, should include company name and place of incorporation, and where applicable, the rationale behind the particular structure employed). The objective should always be to follow the chain of ownership to the individuals who are the ultimate beneficial owners of the direct client of a practice and to verify the identity of those individuals.

4. It is would not be necessary, as a matter of routine, to verify the details of the intermediate companies in the ownership structure of a company. Complex ownership structures (e.g., structures involving multiple layers, different jurisdictions, trusts, etc.) without an obvious commercial purpose pose an increased risk and may require further steps to be satisfied on reasonable grounds as to the identity of the beneficial owners.

5. The need to verify the intermediate corporate layers of the ownership structure of a company will therefore depend upon the overall understanding of the structure, the assessment of the risks and whether the information available is sufficient in the circumstances to consider whether adequate measures have been taken to identify the beneficial owners.

6. Where the ownership is dispersed, the focus should be on on identifying and taking reasonable measures to verify the identity of those who exercise ultimate control over the management of the company.

Partnerships and unincorporated bodies

7. Partnerships and unincorporated bodies, although principally operated by individuals or groups of individuals, are different from individuals, in that there is an underlying business. This business is likely to have a different ML/TF risk profile from that of an individual.

8. In relation to beneficial owners of partnerships, in normal, non-high risk, situations, AMLO requires verification of the identity of a beneficial owner, where that person is:
   (a) an individual who
      (i) is entitled to or controls, directly or indirectly, more than a 25% share of the capital or profits of the partnership;

(ii) is, directly or indirectly, entitled to exercise or control the exercise of more than 25% of the voting rights in the partnership; or
(iii) exercises ultimate control over the management of the partnership; or

(b) if the partnership is acting on behalf of another person, means the other person.

9. In relation to an unincorporated body other than a partnership, beneficial owner:
(a) means an individual who ultimately owns or controls the unincorporated body; or
(b) if the unincorporated body is acting on behalf of another person, means the other person.

10. Generally, the following information in relation to the partnership or unincorporated body may be obtained:
(a) the full name;
(b) the business address; and
(c) the names of all partners and individuals who exercise control over the management of the partnership or unincorporated body, and names of individuals who own or control more than 25% of its capital or profits, or of its voting rights.

11. In cases where a partnership arrangement exists, a mandate from the partnership authorising the business activity and conferring authority on those who will undertake it may usually be obtained.

12. The identity of the client should be verified using evidence from a reliable and independent source. Where partnerships or unincorporated bodies are well-known, reputable organisations, with long histories in their industries, and with substantial public information about them, their partners and controllers, confirmation of the client's membership of a relevant professional or trade association is likely to be sufficient to provide such reliable and independent evidence of the identity of the client. Reasonable measures will generally still need to be taken to verify the identity of the beneficial owners of the partnerships or unincorporated bodies.

13. Other partnerships and unincorporated bodies have a lower profile, and generally comprise a much smaller number of partners and controllers. In verifying the identity of such clients, regard may be had to the number of partners and controllers. Where these are relatively few, the client may be treated as a collection of individuals; where numbers are larger, it may be decided whether to continue to regard the client as a collection of individuals, or whether to be satisfied with evidence of membership of a relevant professional or trade association. In either case, the partnership deed (or other evidence in the case of sole traders or other unincorporated bodies), may be sought to ascertain that the entity exists, unless an entry in an appropriate national register may be checked.

14. In the case of associations, clubs, societies, charities, religious bodies, institutes, mutual and friendly societies, co-operative and provident societies, satisfaction should be obtained as to the legitimate purpose of the organisation, e.g., by requesting sight of the constitution.

Trusts

General

15. A trust does not possess a separate legal personality. It cannot form business relationships or carry out one-off or ad hoc transactions itself. It is the trustee who enters into a business relationship or carries out transactions on behalf of the trust and who is considered to be the client (i.e. the trustee is acting on behalf of a third party – the trust and the individuals concerned with the trust).

16. In relation to beneficial owners of trusts, in normal, non-high risk, situations, AMLO requires verification of the identity of a beneficial owner, where that person is:
(a) an individual who is entitled to a vested interest in not less than 25% of the capital of the trust property, whether the interest is in possession or in remainder or reversion

and whether it is defeasible or not;
(b) the settlor of the trust;
(c) a protector or enforcer of the trust; or
(d) an individual who has ultimate control over the trust.

17. The following identification information in respect of a trust on whose behalf the trustee (i.e., the client) is acting may be obtained:
(a) the name of the trust;
(b) date of establishment/settlement;
(c) the jurisdiction whose laws govern the arrangement, as set out in the trust instrument;
(d) the identification number (if any) granted by any applicable official bodies (e.g. tax identification number or registered charity or non-profit organisation number);
(e) identification information of trustee(s), in line with guidance for individuals or corporations;
(f) identification information of settlor(s) and any protector(s) or enforcers, in line with the guidance for individuals/corporations; and
(g) identification information of known beneficiaries. Known beneficiaries mean those persons or that class of persons who can, from the terms of the trust instrument, be identified as having a reasonable expectation of benefiting from the trust capital or income.

Verifying the trust

18. Generally, the name and date of establishment of a trust should be verified and appropriate evidence to verify the existence, legal form and parties to it, i.e., trustee, settlor, protector, beneficiary, etc. may be obtained. The beneficiaries should be identified as far as possible, where defined. If the beneficiaries are yet to be determined, the focus may be on identifying the settlor and/or the class of persons in whose interest the trust is set up. The most direct method of satisfying this requirement is to review the appropriate parts of the trust deed.

19. Reasonable measures to verify the existence, legal form and parties to a trust, having regard to the ML/TF risk, may include:
(a) reviewing a copy of the trust instrument and retaining a redacted copy;
(b) by reference to an appropriate register[58] in the relevant country of establishment;
(c) a written confirmation from a trustee acting in a professional capacity[59]; or
(d) a written confirmation from a lawyer who has reviewed the relevant instrument.

20. Reasonable measures may still need to be taken to verify the actual identity of the individual parties (i.e., trustee, settlor, protector, beneficiary, etc.).

21. Where only a class of beneficiaries is available for identification, the focus may be on seeking to ascertain and name the scope of the class (e.g., children of a named individual).

22. Particular care may need to be taken in relation to trusts created in jurisdictions where there is no AML/CFT framework similar to Hong Kong's.

---

58 In determining whether a register is appropriate, regard should be had to adequate transparency (e.g., a system of central registration where a national registry records details on trusts and other legal arrangements registered in that country). Changes in ownership and control information would need to be kept up-to-date.

59 "Trustees acting in their professional capacity" in this context means that they act in the course of a profession or business which consists of or includes the provision of services in connection with the administration or management of trusts (or a particular aspect of the administration or management of trusts).

APPENDIX D

SUSPICIOUS TRANSACTION INDICATORS AND EXAMPLES OF SITUATIONS THAT COULD GIVE RISE TO SUSPICIONS

General indicators

1. The types of transactions that may be used for ML/TF are wide-ranging and so it is not possible to specify all the transactions that might arouse suspicion.

2. Indicators of suspicious transactions should be considered, such as the nature and parties involved, including the involvement of jurisdictions that insufficiently apply FATFRs and persons designated as terrorists published in the Government Gazette.

3. Particular care should be taken when, for example, companies have very complex ownership structures that do not seem to serve any legitimate purpose, or when a company is incorporated or administered in a jurisdiction designated by FATF among the Non-Cooperative Countries and Territories. More information on these countries/ territories can be found on the FATF website.

4. The JFIU state that common indicators of suspicious activities associated with ML/TF in Hong Kong include:[60]
   - (a) large or frequent cash transactions, either deposits or withdrawals;
   - (b) suspicious activity based on transaction patterns, e.g.,
     - (i) accounts used as a temporary repository for funds;
     - (ii) a period of significantly increased activity amid relatively dormant periods;
     - (iii) "Structuring" or "smurfing" i.e., many lower-value transactions conducted when one, or a few, large transactions could be used. This is common in incoming remittances from countries with value-based transaction reporting requirements, e.g., frequent remittances just below AU$10,000 from Australia or US$10,000 from United States;
     - (iv) "U-turn" transactions, i.e., where money passes from one person or company to another and then back to the original person or company; and
     - (v) increased level of account activity on the first banking day after Hong Kong horse racing, normally Mondays and Thursdays, which may indicate illegal bookmaking.
   - (c) involvement of one or more of the following entities, which are common in money laundering,
     - (i) shelf or shell companies;
     - (ii) companies registered in a known "tax haven" or "off-shore financial centre";
     - (iii) company formation agent, or secretarial company, as the authorised signatory of the bank account;
     - (iv) remittance agents or money changers; and
     - (v) casinos.
   - (d) currencies, countries or nationals of countries, commonly associated with international crime, or drug trafficking, or identified as having serious deficiencies in their AML/CFT regimes;
   - (e) clients who refuse, or are unwilling, to provide explanations of financial activities, or provide explanations assessed to be untrue;
   - (f) activity that is unexpected of clients, considering existing knowledge about the clients and their previous financial activity. For personal accounts, relevant considerations include clients' age, occupation, residential address, general appearance, type and level of previous financial activity. For company accounts, relevant considerations include the type and level of activity;

60 See the JFIU website at: **https://www.jfiu.gov.hk/en/str_screen.html**

(g) countries, or nationals of countries, commonly associated with terrorist activities or the persons or organisations designated as terrorists or their associates; and
(h) international and domestic PEPs; that is, individuals who hold important positions in governments or the public sector, who may be more vulnerable to corruption and involvement in abuse of public funds.

Situations that may give rise to suspicions

5. Examples of situations that could give rise to suspicion, depending on the circumstances, include the following:
   (a) activities, service requests or transactions that have no apparent legitimate purpose and/or appear not to have a commercial rationale;
   (b) activities, service requests or transactions that involve apparently unnecessary complexity or which do not constitute the most logical, convenient or secure way to do business;
   (c) where the service or transaction being requested by the client, without reasonable explanation, is out of the ordinary range of services normally requested;
   (d) where, without reasonable explanation, the size or pattern of activities or transactions is out of line with any pattern that has previously emerged;
   (e) where the client refuses to provide the information requested without reasonable explanation or otherwise refuses to cooperate with the CDD and/or the ongoing monitoring process;
   (f) where a client that has entered into a business relationship uses the relationship for a single service or for only a very short period without a reasonable explanation;
   (g) the extensive use of trusts or offshore structures in circumstances where the client's needs are inconsistent with the use of such services;
   (h) activities or transactions involving high-risk jurisdictions without reasonable explanation, which are not consistent with the client's declared business dealings or interests; and
   (i) unnecessary routing of funds or other property from/to third parties or through third party accounts.

6. Reference can also be made to:
   (a) Suspicious transaction indicators for accountants in the publication, **Anti-Money Laundering & Counter Terrorist Financing**, published by the Narcotics Division, Security Bureau, June 2009 (paragraph 4.5).
   (b) Characteristics of financial transactions that may be a cause for increased scrutiny contained in Annex 1 of FATF's **Guidance for Financial Institutions in Detecting Terrorist Financing**.
   (c) Relevant overseas examples, such as the general and accountancy-specific suspicious transaction indicators in **Guideline 2: Suspicious Transactions**, issued by the Financial Transactions and Reports Analysis Centre of Canada.

APPENDIX E: Glossary of key terms and abbreviations, and definitions

Terms / abbreviations	Meaning
AMLO	Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions and Designated Non-Financial Businesses and Professions) Ordinance (Cap. 615)
AML/CFT	Anti-money laundering and counter financing of terrorism
Beneficial owner	(a) In relation to a corporation— (i) means an individual who— A. owns or controls, directly or indirectly, including through a trust or bearer share holding, more than 25% of the issued share capital of the corporation; B. is, directly or indirectly, entitled to exercise or control the exercise of more than 25% of the voting rights at general meetings of the corporation; or C. exercises ultimate control over the management of the corporation; or (ii) if the corporation is acting on behalf of another person, means the other person; (b) in relation to a partnership— (i) means an individual who— A. is entitled to or controls, directly or indirectly, more than a 25% share of the capital or profits of the partnership; B. is, directly or indirectly, entitled to exercise or control the exercise of more than 25% of the voting rights in the partnership; or C. exercises ultimate control over the management of the partnership; or (ii) if the partnership is acting on behalf of another person, means the other person; (c) in relation to a trust, means— (i) an individual who is entitled to a vested interest in more than 25% of the capital of the trust property, whether the interest is in possession or in remainder or reversion and whether it is defeasible or not; (ii) the settlor of the trust; (iii) a protector or enforcer of the trust; or (iv) an individual who has ultimate control over the trust; and (d) in relation to a person not falling within paragraph (a), (b) or (c)— (i) means an individual who ultimately owns or controls the person; or (ii) if the person is acting on behalf of another person, means the other person.

Business relationship	A business relationship between a person and a practice is a business, professional or commercial relationship: (i) that has an element of duration; or (ii) that the practice, at the time the person first contacts it in the person's capacity as a potential client of the practice, expects to have an element of duration. ***This can be distinguished from an occasional or ad hoc assignment or transaction, which is an assignment or transaction by a practice for a client with which the practice does not have a business relationship.***
CDD	Client due diligence
CO	Compliance officer
Connected parties	Connected parties to a client include the beneficial owner and any natural person having the power to direct the activities of the client. For the avoidance of doubt, the term connected party will include any director, shareholder, beneficial owner, signatory, trustee, settlor/grantor/founder, protector(s), or defined beneficiary of a legal arrangement.
DNFBP (under AMLO)	Designated non-financial businesses and professions means: (a) an accounting professional; (b) an estate agent; (c) a legal professional; or (d) a TCSP licensee; "*accounting professional*" means— (a) a certified public accountant or a certified public accountant (practising), as defined by section 2(1) of the Professional Accountants Ordinance (Cap. 50); (b) a corporate practice as defined by section 2(1) of the Professional Accountants Ordinance (Cap. 50); or (c) a firm of certified public accountants (practising) registered under Part IV of the Professional Accountants Ordinance (Cap. 50); "*TCSP licensee*" is a person licensed under AMLO to carry on a trust or company service business, *"Trust or company service"* as defined in Schedule 1 Part 1 of AMLO, i.e., those services referred to in paragraph 600.2.2 of these Guidelines
DTROP	Drug Trafficking (Recovery of Proceeds) Ordinance (Cap. 405)
EDD	Enhanced client due diligence

FATF	Financial Action Task Force
FATFR	Financial Action Task Force Recommendations
FI	Financial institution
ICO	Insurance Companies Ordinance (Cap. 41)
Individual	Individual means a natural person, other than a deceased natural person.
Institute	Hong Kong Institute of Certified Public Accountants
JFIU	Joint Financial Intelligence Unit
Minor	Minor means a person who has not attained the age of 18 years (Interpretation and General Clauses Ordinance (Cap. 1) - section 3)
MLRO	Money laundering reporting officer
Money laundering	As defined in Schedule 1 of AMLO. (See also section 600.3 of these Guidelines)
ML/TF	Money laundering and/or terrorist financing
Occasional transaction	A transaction between a DNFBP and a client who does not have a business relationship with the DNFBP
OSCO	Organised and Serious Crimes Ordinance (Cap. 455)
PEP	Politically exposed person
Relevant authority	As defined in AMLO, Schedule 1, Part 2, which are the regulators for the FIs and licensed money service operators
RBA	Risk-based approach to CDD and ongoing monitoring
Regulatory body	As defined in AMLO, Schedule 1, Part 2, which are the regulator for the DNFBPs , including, for an accounting professional, the HKICPA
RK	Record-keeping
Schedule 2	Schedule 2 to the AMLO
SDD	Simplified client due diligence

Senior management	Senior management means partners, directors (or board) and senior managers (or equivalent) of a firm who are responsible, either individually or collectively, for management and supervision of the firm's business. This may include a firm's chief executive officer, managing director, or other senior operating management personnel (as the case may be).
SFO	Securities and Futures Ordinance (Cap. 571)
STR	Suspicious transaction report; also referred to as "report" or "disclosure"
Terrorist financing	As defined in Schedule 1 of AMLO. (See also section 600.3 of these Guidelines)
Trust	For the purposes of the guideline, a trust means an express trust or any similar arrangement for which a legal-binding document (i.e. a trust deed or in any other form) is in place.
UNATMO	United Nations (Anti-Terrorism Measures) Ordinance (Cap. 575)
UNSO	United Nations Sanctions Ordinance (Cap. 537)

DEFINITIONS

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

Acceptable level	A level at which a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances available to the professional accountant at that time, that compliance with the fundamental principles is not compromised.
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	The responsible party that is the person (or persons) who: (a) In a direct reporting engagement, is responsible for the subject matter; or (b) In an assertion-based engagement, is responsible for the subject matter information and may be responsible for the subject matter.
Assurance engagement	An engagement in which a professional accountant in public practice expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria. (For guidance on assurance engagements see the Hong Kong Framework for Assurance Engagements which describes the elements and objectives of an assurance engagement and identifies engagements to which Hong Kong Standards on Auditing (HKSAs), Hong Kong Standards on Review Engagements (HKSREs) and Hong Kong Standards on Assurance Engagements (HKSAEs) apply.)
Assurance team	(a) All members of the engagement team for the assurance engagement; (b) All others within a firm who can directly influence the outcome of the assurance engagement, including: (i) those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the assurance engagement partner in connection with the performance of the assurance engagement; (ii) those who provide consultation regarding technical or industry specific issues, transactions or events for the assurance engagement; and (iii) those who provide quality control for the assurance engagement, including those who perform the engagement quality control review for the assurance engagement.

Audit client	An entity in respect of which a firm conducts an audit engagement. When the client is a listed entity, audit client will always include its related entities. When the audit client is not a listed entity, audit client includes those related entities over which the client has direct or indirect control.
Audit engagement	A reasonable assurance engagement in which a professional accountant in public practice expresses an opinion whether financial statements are prepared, in all material respects (or give a true and fair view or are presented fairly, in all material respects,), in accordance with an applicable financial reporting framework, such as an engagement conducted in accordance with Hong Kong Standards on Auditing. This includes a Statutory Audit, which is an audit required by legislation or other regulation.
Audit team	(a) All members of the engagement team for the audit engagement; (b) All others within a firm who can directly influence the outcome of the audit engagement, including: (i) Those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the engagement partner in connection with the performance of the audit engagement including those at all successively senior levels above the engagement partner through to the individual who is the firm's Senior or Managing Partner (Chief Executive or equivalent); (ii) Those who provide consultation regarding technical or industry-specific issues, transactions or events for the engagement; and (iii) Those who provide quality control for the engagement, including those who perform the engagement quality control review for the engagement; and (c) All those within a network firm who can directly influence the outcome of the audit engagement.
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 of a transaction or the result of the services performed by the firm. A fee that is established by a court or other public authority is not a contingent fee.
Direct financial interest	A financial interest: (c) Owned directly by and under the control of an individual or entity (including those managed on a discretionary basis by others); or (d) Beneficially owned through a collective investment vehicle, estate, trust or other intermediary over which the individual or entity has control, or the ability to influence investment decisions.

Director or officer	Those charged with the governance of an entity, or acting in an equivalent capacity, regardless of their title, which may vary from jurisdiction to jurisdiction.
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, on or before the report is issued, of the significant judgments the engagement team made and the conclusions it reached in formulating the report.
Engagement team	All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform assurance procedures on the engagement. This excludes external experts engaged by the firm or by a network firm. The term "engagement team" also excludes individuals within the client's internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of HKSA 610 (Revised 2013), *Using the Work of Internal Auditors.*[*]
Existing accountant	A professional accountant in public practice currently holding an audit appointment or carrying out accounting, taxation, consulting or similar professional services for a client.
External expert	An individual (who is not a partner or a member of the professional staff, including temporary staff, of the firm or a network firm) or organization possessing skills, knowledge and experience in a field other than accounting or auditing, whose work in that field is used to assist the professional accountant in obtaining sufficient appropriate evidence.
Financial interest	An interest in an equity or other security, debenture, loan or other debt instrument of an entity, including rights and obligations to acquire such an interest and derivatives directly related to such interest.
Financial statements	A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The term can relate to a complete set of financial statements, but it can also refer to a single financial statement, for example, a balance sheet, or a statement of revenues and expenses, and related explanatory notes.

[*] HKSA 610 (Revised 2013) establishes limits on the use of direct assistance. It also acknowledges that the external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors. Therefore, the use of direct assistance is restricted to situations where it is permitted.

Financial statements on which the firm will express an opinion	In the case of a single entity, the financial statements of that entity. In the case of consolidated financial statements, also referred to as group financial statements, the consolidated financial statements.
Firm	(a) A sole practitioner, partnership or corporation of professional accountants; (b) An entity that controls such parties, through ownership, management or other means; and (c) An entity controlled by such parties, through ownership, management or other means.
Historical financial information	Information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.
Immediate family	A spouse (or equivalent) or dependent.
Independence	Independence is: (a) Independence of mind – the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity, and exercise objectivity and professional skepticism (b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that a firm's, or a member of the audit or assurance team's, integrity, objectivity or professional skepticism has 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 or ability to influence investment decisions.
Key audit partner	The engagement partner, the individual responsible for the engagement quality control review, and other audit partners, if any, on the engagement team who make key decisions or judgments on significant matters with respect to the audit of the financial statements on which the firm will express an opinion. Depending upon the circumstances and the role of the individuals on the audit, "other audit partners" may include, for example, audit partners responsible for significant subsidiaries or divisions.
Listed entity	An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.

Network	A larger structure: (a) That is aimed at co-operation; and (b) That is clearly aimed at profit or cost sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand-name, or a significant part of professional resources.
Network firm	A firm or entity that belongs to a network.
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.
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 activity	An activity requiring accountancy or related skills undertaken by a professional accountant, including accounting, auditing, taxation, management consulting, and financial management.
Professional services	Professional activities performed for clients.
Public interest entity	(a) A listed entity; and (b) An entity: (i) defined by regulation or legislation as a public interest entity; or (ii) for which the audit is required by regulation or legislation to be conducted in compliance with the same independence requirements that apply to the audit of listed entities. Such regulation may be promulgated by any relevant regulator, including an audit regulator.
Related entity	An entity that has any of the following relationships with the client: (a) An entity that has direct or indirect control over the client if the client is material to such entity; (b) An entity with a direct financial interest in the client if that entity has significant influence over the client and the interest in the client is material to such entity;

(c) An entity over which the client has direct or indirect control;

(d) An entity in which the client, or an entity related to the client under (c) above, has a direct financial interest that gives it significant influence over such entity and the interest is material to the client and its related entity in (c); and

(e) An entity which is under common control with the client (a "sister entity") if the sister entity and the client are both material to the entity that controls both the client and sister entity.

Review client — An entity in respect of which a firm conducts a review engagement.

Review engagement — An assurance engagement, conducted in accordance with Hong Kong Standards on Review Engagements or equivalent, in which a professional accountant in public practice expresses a conclusion on whether, on the basis of the procedures which do not provide all the evidence that would be required in an audit, anything has come to the accountant's attention that causes the accountant to believe that the financial statements are not prepared, in all material respects, in accordance with an applicable financial reporting framework.

Review team

(a) All members of the engagement team for the review engagement; and

(b) All others within a firm who can directly influence the outcome of the review engagement, including:

  (i) Those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the engagement partner in connection with the performance of the review engagement including those at all successively senior levels above the engagement partner through to the individual who is the firm's Senior or Managing Partner (Chief Executive or equivalent);

  (ii) Those who provide consultation regarding technical or industry specific issues, transactions or events for the engagement; and

  (iii) Those who provide quality control for the engagement, including those who perform the engagement quality control review for the engagement; and

(c) All those within a network firm who can directly influence the outcome of the review engagement.

Special purpose financial statements — Financial statements prepared in accordance with a financial reporting framework designed to meet the financial information needs of specified users.

Those charged with governance — The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.

Effective Date

The Code (Part A to Part D) is effective on 1 January 2011; early adoption is permitted. The Code is subject to the following transitional provisions:

Public Interest Entities

1. Section 290 of the Code contains additional independence provisions when the audit or review client is a public interest entity. The additional provisions that are applicable because of the new definition of a public interest entity or the guidance in paragraph 290.26 are effective on 1 January 2012. For partner rotation requirements, the transitional provisions contained in paragraphs 2 and 3 below apply

Partner Rotation

2. For a partner who is subject to the rotation provisions in paragraph 290.149 because the partner meets the definition of the new term "key audit partner," and the partner is neither the engagement partner nor the individual responsible for the engagement quality control review, the rotation provisions are effective for the audits or reviews of financial statements for years beginning on or after 15 December 2011. For example, in the case of an audit client with a calendar year-end, a key audit partner, who is neither the engagement partner nor the individual responsible for the engagement quality control review, who had served as a key audit partner for seven or more years (i.e., the audits of 2003 – 2010), would be required to rotate after serving for one more year as a key audit partner (i.e., after completing the 2011 audit).

3. For an engagement partner or an individual responsible for the engagement quality control review who immediately prior to assuming either of these roles served in another key audit partner role for the client, and who, at the beginning of the first fiscal year beginning on or after 15 December 2010, had served as the engagement partner or individual responsible for the engagement quality control review for six or fewer years, the rotation provisions are effective for the audits or reviews of financial statements for years beginning on or after 15 December 2011. For example, in the case of an audit client with a calendar year-end, a partner who had served the client in another key audit partner role for four years (i.e., the audits of 2002-2005) and subsequently as the engagement partner for five years (i.e., the audits of 2006-2010) would be required to rotate after serving for one more year as the engagement partner (i.e., after completing the 2011 audit).

Non-assurance services

4. Paragraphs 290.154-290.216 address the provision of non-assurance services to an audit or review client. If, at the effective date of the Code, services are being provided to an audit or review client and the services were permissible under the June 2005 Code (revised July 2006) but are either prohibited or subject to restrictions under the revised Code, the firm may continue providing such services only if they were contracted for and commenced prior to 1 January 2011, and are completed before 1 July 2011.

Fees – Relative Size

5. Paragraph 290.219 provides that, in respect of an audit or review client that is a public interest entity, when the total fees from that client and its related entities (subject to the considerations in paragraph 290.27) for two consecutive years represent more than 15% of the total fees of the firm expressing the opinion on the financial statements, a pre- or post-issuance review (as described in paragraph 290.219) of the second year's audit shall be performed. This requirement is effective for audits or reviews of financial statements covering years that begin on or after 15 December 2010. For example, in the case of an audit client with a calendar year end, if the total fees from the client exceeded the 15% threshold for 2011 and 2012, the pre- or post-issuance review would be applied with respect to the audit of the 2012 financial statements.

Compensation and Evaluation Policies

6. Paragraph 290.226 provides that a key audit partner shall not be evaluated or compensated based on that partner's success in selling non-assurance services to the partner's audit client. This requirement is effective on 1 January 2012. A key audit partner may, however, receive compensation after 1 January 2012 based on an evaluation made prior to 1 January 2012 of that partner's success in selling non-assurance services to the audit client.

APPENDIX 1

Sample Code of Conduct under the Prevention of Bribery Ordinance

Introduction

1. The *(name of company)* (hereafter referred to as the Company) regards honesty, integrity and fair play as our core values that must be upheld by all directors and staff [1] of the Company at all times. This Code sets out the basic standard of conduct expected of all directors and staff, and the Company's policy on acceptance of advantage and handling of conflict of interest when dealing with the Company's business.

Prevention of Bribery

Prevention of Bribery Ordinance

2. Under the Prevention of Bribery Ordinance (the Ordinance), any director or staff member who, without the permission of his employer or principal (i.e. the Company), solicits or accepts an advantage as a reward or inducement for doing any act or showing favour in relation to the latter's business, commits an offence. The person offering the advantage also commits an offence.

(The relevant provisions of Section 9 of the Ordinance and the definition of "advantage" are detailed at **Annex 1**.)

Acceptance of Advantage

3. It is the Company's policy that directors and staff, in their private capacity, should not solicit or accept an advantage from any person, company or organization having business dealings with the Company, except that they may accept (but not solicit) the following advantages when offered on a voluntary basis:

   (a) advertising or promotional gifts or souvenirs of a nominal value; or

   (b) gifts given on festive or special occasions, subject to a maximum limit of $_____ in value; or

   (c) discounts or other special offers given by any person or company to them as customers, on terms and conditions equally applicable to other customers in general; or

   (d) gifts or souvenirs of nominal value presented to them in official functions.

   No director or staff member should, in his/her private capacity, accept any advantage from a subordinate, except those mentioned in paragraphs (a) and (b) above.

4. Gifts or souvenirs described in paragraph 3(d) above are deemed as offers to the Company. The directors and staff members concerned should report the acceptance to the Company and seek direction as to how to handle the gifts or souvenirs from *the approving authority* [2] using Form A (**Annex 2**). If a director or staff member wishes to accept any advantage not covered in paragraph 3, he/she should also seek permission from *the approving authority* using Form A.

---

1 "Staff" cover full-time, part-time and temporary staff, except where specified.

2 Specify the post of the approving authority in the Code and the Form.

5. However, a director or staff member should decline an offer of advantage if acceptance could affect his/her objectivity in conducting the Company's business or induce him/her to act against the interest of the Company, or acceptance will likely lead to perception or allegation of impropriety.

6. If a director or staff member has to act on behalf of a client in the course of carrying out the Company's business, he/she should also comply with any additional restrictions on acceptance of advantage that may be set by the client.

Offer of Advantage

7. Directors and staff are prohibited from offering advantages to any director or staff of another company or organization, for the purpose of influencing such person or company in any dealings, or any public official, whether directly or indirectly through a third party, when conducting the Company's business.

Entertainment

8. As defined in Section 2 of the Ordinance, "entertainment" refers to food or drink provided for immediate consumption on the occasion, and any other entertainment provided at the same time. Although entertainment is an acceptable form of business and social behaviour, a director or staff member should avoid accepting overly lavish or frequent entertainment from persons with whom the Company has business dealings (e.g. suppliers or contractors) or from his/her subordinates to avoid placing himself/herself in a position of obligation.

Records, Accounts and other Documents

9. Directors and staff should ensure that all records, receipts, accounts or other documents they submit to the Company, give a true representation of the events or business transactions as shown in the documents. Intentional use of documents containing false information to deceive or mislead the Company, regardless of whether there is any gain or advantage involved, may constitute an offence under the Ordinance.

Compliance with Laws of Hong Kong and in Other Jurisdictions

10. Directors or staff must comply with all local laws and regulations when conducting the Company's business, and also those in other jurisdictions when conducting business there.

Conflict of Interest

11. Directors and staff should avoid any conflict of interest situation (i.e. situation where their private interest conflicts with the interest of the Company) or the perception of such conflicts. They should not misuse their position or authority in the Company to pursue their own private interests which include both financial or personal interests and those of their family members, relatives or close personal friends. When actual or potential conflict of interest arises, the director or staff member should make a declaration to the management through the reporting channel using Form B (**Annex 3**).

12. Some common examples of conflict of interest are described below but they are by no means exhaustive:

    (a) A staff member involved in a procurement exercise is closely related to or has financial interest in the business of a supplier who is being considered for selection by the Company.

(b) One of the candidates under consideration in a recruitment or promotion exercise is a family member, a relative or a close personal friend of the staff member involved in the process.

(c) A director of the Company has financial interest in a company whose quotation or tender is under consideration by the Board.

(d) A staff member (full-time or part-time) undertaking part-time work with a contractor whom he is responsible for monitoring.

Use of Company Assets

13. Directors and staff in charge of or having access to any Company assets, including funds, property, information, and intellectual property, should use them solely for the purpose of conducting the Company's business. Unauthorized use, such as misuse for personal gain, is strictly prohibited.

Confidentiality of Information

14. Directors and staff should not disclose any classified information of the Company without authorization or misuse any Company information (e.g. unauthorized sale of the information). Those who have access to or are in control of such information, including information in the Company's computer system, should at all times protect the information from unauthorized disclosure or misuse. Special care should also be taken in the use of any personal data, including directors', staff's and customers' personal data, to ensure compliance with the Personal Data (Privacy) Ordinance (Cap. 486).

Outside Employment

15. Any full time staff who wish to take up employment outside the Company, must seek the prior written approval of *the approving authority*. The approving authority should consider whether the outside employment would give rise to a conflict of interest with the staff's duties or the interest of the Company.

Relationship with Suppliers, Contractors and Customers

Gambling

16. Directors and staff are advised not to engage in frequent gambling activities (e.g. mahjong) with persons having business dealings with the Company.

Loans

17. Directors and staff should not accept any loan from, or through the assistance of, any individual or organization having business dealings with the Company. There is however no restriction on borrowing from licensed banks or financial institutions.

[*The Company may wish to include other guidelines on the conduct required of directors and staff in their dealings with suppliers, contractors, customers, and other business partners as appropriate to specific trades.*]

Compliance with the Code

18. It is the responsibility of every director and staff member of the Company to understand and comply with this Code, whether performing his company duties in or outside Hong Kong. Managers and supervisors should also ensure that the staff under their supervision understand well and comply with this Code.

19. Any director or staff member in breach of this Code will be subject to disciplinary action, including termination of appointment. In cases of suspected corruption a report should be made to the ICAC and other criminal offences, to the appropriate authority.

20. Any enquiries about this Code or reports of possible breaches of this Code should be made to (post of designated senior staff).

_____

(*Name of Company*)

Date:

Annex 1

Extracts of the Prevention of Bribery Ordinance

Section 9

(1) Any agent who, without lawful authority or reasonable excuse, solicits or accepts any advantage as an inducement to or reward for or otherwise on account of his –

(a) doing or forbearing to do, or having done or forborne to do, any act in relation to his principal's affairs or business; or

(b) showing or forbearing to show, or having shown or forborne to show, favour or disfavour to any person in relation to his principal's affairs or business,

shall be guilty of an offence.

(2) Any person, who, without lawful authority or reasonable excuse, offers any advantage to any agent as an inducement to or reward for or otherwise on account of the agent's –

(a) doing or forbearing to do, or having done or forborne to do, any act in relation to his principal's affairs or business; or

(b) showing or forbearing to show, or having shown or forborne to show, favour or disfavour to any person in relation to his principal's affairs or business,

shall be guilty of an offence.

(3) Any agent who, with intent to deceive his principal, uses any receipt, account or other document –

(a) in respect of which the principal is interested; and

(b) which contains any statement which is false or erroneous or defective in any material particular; and

(c) which to his knowledge is intended to mislead the principal,

shall be guilty of an offence.

(4) If an agent solicits or accepts an advantage with the permission of his principal, being permission which complies with subsection (5), neither he nor the person who offered the advantage shall be guilty of an offence under subsection (1) or (2).

(5) For the purpose of subsection (4) permission shall –

(a) be given before the advantage is offered, solicited or accepted; or

(b) in any case where an advantage has been offered or accepted without prior permission, be applied for and given as soon as reasonably possible after such offer or acceptance,

and for such permission to be effective for the purpose of subsection (4), the principal shall, before giving such permission, have regard to the circumstances in which it is sought.

Section 2

'Advantage' means :

(a) any gift, loan, fee, reward or commission consisting of money or of any valuable security or of other property or interest in property of any description;

(b) any office, employment or contract;

(c) any payment, release, discharge or liquidation of any loan, obligation or other liability, whether in whole or in part;

(d) any other service, or favour (other than entertainment), including protection from any penalty or disability incurred or apprehended or from any action or proceedings of a disciplinary, civil or criminal nature, whether or not already instituted;

(e) the exercise or forbearance from the exercise of any right or any power or duty; and

(f) any offer, undertaking or promise, whether conditional or unconditional, of any advantage within the meaning of any of the preceding paragraphs (a), (b), (c), (d) and (e),

but does not include an election donation within the meaning of the Elections (Corrupt and Illegal Conduct) Ordinance (10 of 2000), particulars of which are included in an election return in accordance with that Ordinance.

'Entertainment' means :

The provision of food or drink, for consumption on the occasion when it is provided, and of any other entertainment connected with, or provided at the same time as, such provisions.

Section 19

In any proceedings for an offence under this Ordinance, it shall not be a defence to show that any such advantage as is mentioned in this Ordinance is customary in any profession, trade, vocation or calling.

Annex 2

Form A

(Company Name)

REPORT ON GIFTS RECEIVED

Part A – To be completed by Receiving Staff

To : (Approving Authority)

Description of Offeror *:*

Name & Title of Offeror : _____

Company : _____

Relationship (Business / Personal) : _____

Occasion on which the Gift
was / is to be received : _____

Description & (assessed) value of the Gift :
_____

Suggested Method of Disposal :		*Remark*
( )	Retain by the Receiving Staff	_____
( )	Retain for Display / as a Souvenir in the Office	_____
( )	Share among the Office	_____
( )	Reserve as Lucky Draw Prize at Staff Function	_____
( )	Donate to a Charitable Organization	_____
( )	Return to Offeror	_____
( )	Others (please specify) :	_____

_____
(Name of Receiving Staff)

(Date) (Title)

Part B – To be completed by Approving Authority

To : (Name of Receiving Staff)

The recommended method of disposal is ****approved / not approved***. *The gift(s) concerned should be disposed of by way of :

_____
(Name of Approving Authority)

(Date) (Title)

** Delete as appropriate.*

Annex 3

Form B

(Company Name)

Declaration of Conflict of Interest

Part A – Declaration *(To be completed by Declaring Staff)*

To : (Approving Authority) via (supervisor of the Declaring Staff)

I would like to report the following actual/potential* conflict of interest situation arising during the discharge of my official duties:-

Persons/companies with whom/which I have official dealings
My relationship with the persons/companies (e.g. relative)
Relationship of the persons/companies with our Company (e.g. supplier)
Brief description of my duties which involved the persons/companies (e.g. handling of tender exercise)

_____

(Name of Declaring Staff)

(Date) (Title / Department)

Part B – Acknowledgement *(To be completed by Approving Authority)*

To : (Declaring Staff) via (supervisor of the Declaring Staff)

Acknowledgement of Declaration

The information contained in your declaration form of (Date) is noted. It has been decided that:-

- ❑ You should refrain from performing or getting involved in performing the work, as described in Part A, which may give rise to a conflict.
- ❑ You may continue to handle the work as described in Part A, provided that there is no change in the information declared above, and you must uphold the Company's interest without being influenced by your private interest.
- ❑ Others (please specify) :

_____

(Name of Approving Authority)

(Date) (Title / Department)

** Delete as appropriate.*

APPENDIX 2

Comparison with The IESBA Code of Ethics for Professional Accountants

Since 2005, the Institute has adopted the IESBA *Code of Ethics for Professional Accountants* (IESBA Code) as the ethical requirements for its members. Additional guidance has been incorporated to reflect local or legal requirements in Hong Kong. This version of the Code of Ethics for Professional Accountants (Part A to Part C) is based on the IESBA Code.

This comparison appendix deals only with significant differences in the Code of Ethics for Professional Accountants with the IESBA Code, is produced for information only and does not form part of the Code of Ethics for Professional Accountants.

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

	Differences	**Reasons for the Differences**
1.	**Paragraphs 100.10, 100.11, 140.7, 290.41 and 290.49**	The Institute replaced the wording "member body" in the IESBA Code to "the Institute" to adapt for local context.
2.	**Paragraph 240.7A, Footnote 1a and Appendix 1**	The paragraph reflects the legal requirement in Hong Kong and additional guidance on the application of the Prevention of Bribery Ordinance.
3.	**Paragraph 290.25, Footnote 1b**	Additional guidance on the definition of "public interest entity" under the legislation of Hong Kong.
4.	**Paragraph 290.107** of the IESBA Code is 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.
5.	**Paragraph 290.146** of the IESBA Code is modified.	The modification reflects the legal requirement in Hong Kong.
6.	(a) **Part D** on additional ethical requirements is added. (b) **Paragraphs 100.2 and 100.3** of the IESBA 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.