Ethics Resources
for Accounting Professionals

FINANCIAL ACCOUNTANTS

Financial accountants play pivotal roles in most companies. On the one hand, they serve as guardians to check the supporting documents of transactions, ensure the transactions are properly booked and the financial statements are prepared in accordance with the relevant reporting framework. On the other hand, they provide management with important advice relating to tax, asset quality, liability position, cash flow sufficiency, revenue and expense issues of the company. In light of their guiding and advisory roles, financial accountants may face a number of ethical challenges when discharging their duties.

ETHICAL SCENARIOS

Expense reimbursement

How should I handle reimbursement claims with missing, insufficient or even suspected fraudulent supporting documents?

Colleagues who have incurred expenses for official use or functions may be allowed to claim for reimbursement from the company. What if some claims submitted have no or insufficient supporting documents such as purchase orders, delivery notes, invoices and receipts? Or if the supporting documents received appear to be fraudulent? Financial accountants will face an even more difficult dilemma if such claims are submitted by senior management of the company.

Even worse, unscrupulous colleagues may resort to offering bribes or gifts to financial accountants in order to have their claims with missing, insufficient or even fraudulent supporting documents successfully processed.

Pressure from the management

Should I follow the management's request to manipulate financial statements?

For certain reasons (e.g. to satisfy the listing requirements, to show good financial performance of the company), financial accountants may be requested by the senior management to inflate the sales turnover and profit figures in the financial statements by falsifying sales invoices and accounting records. They may also be asked to postpone the recognition of costs and expenses, manipulate the value of inventories, or adopt different depreciation and amortisation methods for the same asset types.

Financial accountants should be aware of the threats as well as understand the legal requirements under the *Prevention of Bribery Ordinance (POBO) (Cap. 201)* and other relevant legislations. The above situations create various threats to the *fundamental principles of ethics for professional accountants*.

PREVENTION OF BRIBERY ORDINANCE

According to Section 9(3) of the Prevention of Bribery Ordinance (POBO), it is an offence if an agent intends to deceive his/her principal by using any false or erroneous or defective receipts, accounts or other documents.

In addition, according to Section 9 of the POBO, an agent (e.g. an employee, a director), without the permission of his/her principal (e.g. the employer, the company) or any reasonable excuse, solicits or accepts any advantage for doing or forbearing to do any act in relation to his/her principal's affairs or business, shall be guilty of an offence.

Advantage refers to anything that is of value such as money, gift, commission, loan, employment, service or favour, except entertainment. Entertainment refers to the provision of food or drink for consumption on the occasion when it is provided, and any other entertainment connected with such provisions.

CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS

Fundamental principles of ethics for professional accountants

According to the Code of Ethics for Professional Accountants (COE) issued by the HKICPA, there are five fundamental principles of ethics for professional accountants (the fundamental principles):

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

(b) **Objectivity** – to exercise professional or business judgment without being compromised by:

- (i) Bias;
- (ii) Conflict of interest; or
- (iii) Undue influence of, or undue reliance on, individuals, organizations, technology or other factors.

(c) **Professional Competence and due care** – to:

- (i) Attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and
- (ii) Act diligently and in accordance with applicable technical and professional standards.

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

(e) **Professional Behaviour** – to:

- (i) Comply with relevant laws and regulations;
- (ii) Behave in a manner consistent with the profession's responsibility to act in the public interest in all professional activities and business relationships; and
- (iii) Avoid any conduct that the professional accountant knows or should know might discredit the profession.

CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS (CONTINUED)

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

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; and

(g) insider dealing.

(Paragraph 500.1, section 500, Chapter C of the COE)

If a member acquires knowledge indicating that his employer or someone acting on behalf of his employer may have been guilty of some default or unlawful act, he should normally raise the matter with management internally at an appropriate level. If his concerns are not satisfactorily resolved, he should report the matter to non-executive directors and those charged with governance where these exist. Where this is not possible or fails to resolve the matter, a member may wish to consider making a report to a third party. Members in business should refer to section 260 under Chapter A of the COE, 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 in section 500 of Chapter C of the COE on reporting suspected defaults or unlawful acts to third parties outside the organisation for which the member works.

KEY ISSUES AND TAKEAWAYS

Expense reimbursement

Irrespective of the rank, staff members, as agents of the company, may breach Section 9(3) of the POBO by intentionally using fraudulent documents to deceive or mislead the company, i.e. their principal.

Financial accountants serve as guardians watching out for malpractices, non-compliance with regulatory requirements and illegal acts committed by staff of the company. In any circumstances, they should ensure that only expenses with sufficient and proper supporting documents could be reimbursed and booked. Otherwise, the fundamental principles may be compromised. In some cases, financial accountants approving claims they know to be improper may be implicated as aiding or abetting the illegal act, hence committing a conspiracy offence.

In addition, financial accountants may commit an offence under Section 9 of the POBO if they accept any advantage (e.g. gifts) for processing colleagues' claims with missing, insufficient or fraudulent supporting documents. They should decline the offer and report the matter to the Independent Commission Against Corruption (ICAC).

Pressure from the management

Similarly, financial accountants may breach Section 9(3) of the POBO by intentionally using false financial statements to deceive or mislead the board or the company. They may also commit a conspiracy to defraud offence if they collude with others to use falsified financial statements to defraud shareholders, investors or creditors.

The pressure for companies, especially listed companies, to show their growth and success may place undue stress on financial accountants in preparing financial statements. Professional accountants shall prepare or present information in a manner that is intended neither to mislead nor influence contractual or regulatory outcomes inappropriately. They must exercise professional judgment to represent the facts accurately and completely in all material respects, describe clearly the true nature of business transactions or activities and classify and record information in a timely and proper manner. Subject to the relevant laws or regulations, they may consider reporting to the board or relevant authority any unethical concern, conflict of interest, malpractice or illegal act unveiled. Professional accountants who choose to manipulate financial statements to paint a false picture of the company's performance are subject to legal liabilities and professional sanctions.

CASE STUDY

FULL OF PITFALLS

1 Matthew, a certified public accountant, was newly appointed as the senior accounting manager of a retail company. He was responsible for supervising the whole financial accounting team and reported to Andrew, the Financial Controller.

2 One of Matthew's duties was to check and approve payment vouchers prepared by his subordinates. Occasionally, some vouchers were found to have insufficient supporting documents and some supporting documents appeared to be bogus.

3 Matthew received a call from Ivy, the Sales Director. Ivy said that she had recently had a business dinner with clients. She asked Matthew to book the expense under the "miscellaneous expenses" account and reimburse her as soon as possible.

4 Matthew found that the cost of the dinner was remarkably high. He also learnt from other sources that the dinner's attendees were all Ivy's relatives and friends. None of the company's clients was present.

Matthew also noted that the accounting system of the company was very outdated which required a lot of manual adjustments.

CASE STUDY (CONTINUED)

FULL OF PITFALLS

5 Besides, Matthew discovered that the company regularly made large payments to a supplier, but the actual shipments delivered by the supplier were much fewer than what the accounting records showed. Matthew found that the supplier was a company owned by Ivy's husband but Ivy had never disclosed this relationship to the company.

6 Matthew reported to Andrew about the suspected misconduct of Ivy. Andrew responded, "In real business life, we have to tolerate these minor variations." Andrew also said that it was too costly to update the accounting system.

7 Andrew further asked Matthew to cooperate in polishing the financial statements. He was promised a good appraisal report and a special "reward" if the company could announce good financial results.

IF YOU WERE MATTHEW, WHAT WOULD YOU DO?

COMMENTARIES ON THE CASE

Expense Reimbursement

Financial accountants should always ensure that only expenses with **sufficient and proper supporting documents** are reimbursed and booked. For procurement of goods and services, three-way matching of the purchase order, delivery note and sales invoice should be performed as far as practicable to ensure accuracy. In the case study, the dinner held was attended by Ivy's relatives and friends. Hence, Ivy might be held liable under Section 9(3) of the POBO for using falsified document to deceive the company into granting reimbursement of the dinner expense.

Conflict of Interest

As Ivy's husband owned the company which was a supplier, Ivy's private interest competed or conflicted with her company's interest. Hence, there was a clear case of conflict of interest for Ivy, the Sales Director. Ivy was also in breach of her fiduciary duties as a senior employee of the company, such as the duty to act in good faith and in the interests of the company, the duty to exercise powers for proper purposes, the duty to avoid conflicts of interest, etc.

Although a conflict of interest does not necessarily amount to a criminal offence, **mishandling conflict of interest** can be conducive to **criminal acts** such as fraud, corruption or submission of false documents to deceive the principal. If Ivy intentionally omitted to declare her relationship with the supplier concerned when submitting documents to declare her financial interests to the company, she would have committed an offence under **Section 9(3) of the POBO** by using false documents with the intent to deceive the company. Also, Ivy and her husband might have breached the common law offence of conspiracy to defraud.

Fabrication of Financial Statements

The act of fabricating financial statements would contravene the COE, or even constitute a deception or false accounting offence. Andrew's offering of "reward" to Matthew may be seen as an internal corruption. If Matthew agreed to collude with Andrew to conceal from the management the real financial position of the company, they may commit a **bribery** or **conspiracy to defraud** offence.

Under section 380 of the Companies Ordinance (Cap. 622), the annual financial statements must give **a true and fair view** of the financial position/performance of the company as at the end of/for the financial year. In addition, under the COE, a professional accountant in business shall:

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

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

(c) Exercise professional judgment to:

- (i) represent the facts accurately and completely in all material respects;
- (ii) describe clearly the true nature of business transactions or activities; and
- (iii) classify and record information in a timely and proper manner; and

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

COMMENTARIES ON THE CASE (CONTINUED)

Report of Misconduct

As the financial controller, Andrew should be responsible for ensuring good governance and offering sound advice on financial and risk management to the company. Instead, he chose to brush Matthew off without giving any useful advice and to tolerate Ivy's misconduct. Andrew failed to perform his duties as a member of senior management to **exercise care, skill and diligence** to address the company's system deficiencies and staff misconduct.

Matthew played a central management role in monitoring the company's operations, in particular overseeing the company's financial activities and accounts to safeguard the company's assets and prevent fraud. When encountering non-compliance or suspected **non-compliance with laws and regulations (NOCLAR)** in the course of carrying out professional activities, Matthew should refer to **section 260 of Chapter A of the COE** which sets out detailed guidance for professional accountants in business on how to respond to NOCLAR committed by the management or any employee of the company.

In gist, Matthew should discuss with his immediate superior or a higher authority of the company, take appropriate steps to rectify or mitigate the consequences of the non-compliance, and decide whether it should be disclosed to the external auditor. Since the board had the ultimate responsibility for risk management and internal control of the company, Matthew should raise the matter to the board, possibly through the Audit Committee, if he did not receive an appropriate response from Andrew.

In addition, Matthew should also determine whether further action was needed, such as disclosing the matter to an appropriate authority and/or resigning from the company. In exceptional circumstances where an imminent breach of a law or regulation would cause substantial harm to investors, creditors, employees or the general public, Matthew should consider immediately disclosing the matter to an appropriate authority to cause the matter to be investigated and action to be taken. Unless the disclosure is precluded by law or regulation, this would not be considered as a breach of the duty of confidentiality.

Accounting System

Very often, companies are cost conscious and reluctant to invest in accounting and IT systems. An outdated accounting system may contribute to an ineffective **internal monitoring system**. As part of the internal control, a company should have adequate accounting functionality for reporting purposes, including the compilation of consolidated accounts for management purposes. Manual adjustments should only be made in special circumstances and with proper justifications.

Besides, it is a good practice to keep the number of ambiguous accounts in an accounting system to the minimum in order to reduce the risk of manipulation. Such accounts include "miscellaneous expenses", "other expenses", "sundry expenses", "other administrative expenses", etc. Transactions should be duly verified before booking in such accounts.

TOPIC OF INTEREST

CONFLICT OF INTEREST

A professional accountant in business may face conflict of interest situations when undertaking professional activities. Conflict of interest refers to a situation where the **private interest** of a professional accountant competes or conflicts with the **interest of the employing organisation**. It creates self-interest threat to objectivity and may create threats to other fundamental principles. Examples of situations in which conflict of interest may arise include:

(a) serving in a governance capacity in the company that is approving certain investments which will increase the value of the personal investment portfolio of the professional accountant or an immediate family member; and

(b) being responsible for selecting a vendor for the company when an immediate family member or a close friend of the professional accountant could benefit financially from the transaction.

Mishandling of conflicts of interest may lead to criminal acts such as fraud against the company, corruption or submission of false documents to deceive the principal. Professional accountants should therefore identify and evaluate the threats and relationships that might create a conflict of interest and implement safeguards, when necessary, to eliminate or reduce any threats in compliance with the fundamental principles to an acceptable level. They should 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 that they might compromise compliance with the fundamental principles.

The fundamental rule should be to **avoid** any conflict of interest, and if it cannot be avoided, the concerned professional accountant, irrespective of the rank, should **declare** the conflict to the approving authority of the company. Following such declaration, the approving authority should take appropriate action to resolve the conflict, such as withdrawing the concerned member from performing the task and putting the matter to the vote.

A company should establish a clear mechanism for its directors and employees to manage conflicts of interest. For example, appointment letters, employment contracts and/or the company's code of conduct should specify the policies concerning handling conflicts of interest.

For more information about handling conflicts of interest by professional accountants in business, please refer to section 210 of Chapter A of the COE.

Established under the auspices of the Community Relations Department of the ICAC, Hong Kong Business Ethics Development Centre (HKBEDC) aims to promote business and professional ethics on a long-term basis to sustain a level-playing field in Hong Kong. We offer free ethics training and consultancy services for business organisations and professional bodies.

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